BOOKKEEPERS' HANDY GUIDE

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BOOKKEEPERS' HANDY GUIDE

A Practical Desk Book

for

Quick Reference

THE RONALD PRESS COMPANY

NEW YORK

Fourth Printing, January 1942

PRINTED IN THE UNITED STATES OF AMERICA

PREFACE

In the preparation of this volume the aim has been to give definite, factual information on bookkeeping practices and procedures in a form to make it quickly available to all who are confronted with specific problems in practical bookkeeping. It is the emphasis on this service aspect of the book—that of giving quick answers to the specific questions that are likely to arise in the practical bookkeeper's daily work—which has motivated all who have collaborated in planning and writing this volume. It is this emphasis which in many respects gives the volume a distinctive character. In organization, in arrangement, in scope and style of presentation the volume differs quite radically from the usual works on bookkeeping intended principally for classroom use.

Every effort has been made to place before the reader information that is accurate and up-to-date, having to do with approved practice. The information is presented in short, self-contained items. Each item treats a specific problem of bookkeeping, or a subject closely allied to bookkeeping and ordinarily falling within the scope of the bookkeeper's work. Where several alternative procedures are in use, these are explained. It has been realized that in bookkeeping some of the seemingly innocent and unimportant practical details are often the cause of much annoyance and embarrassment if not properly attended to at the outset. Accordingly, in preparing this work pains have been taken not to slight such details but to give them the attention which their real practical importance deserves. It has also been the aim to make the explanations full and comprehensive and yet to give them in the briefest possible compass so as to economize the reader's time.

THE RONALD PRESS COMPANY.

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BOOKKEEPERS' HANDY GUIDE

HANDLING CASH RECEIPTS

Separation of Cashier and Bookkeeping Functions—Cash Remittance Sheet—Temporary Disposition of Doubtful Remittances

General Control of Cash Receipts.—In handling cash receipts care should be taken to safeguard them against dishonest persons and insure that proper record will be made of them on the books of account. Various methods are in use, depending upon the conditions obtaining in the office, but all are based on the general principle of separating the actual handling of cash from the recording of it. According to this principle, the duty of handling cash receipts is delegated to the cashier, while the duty of recording them is delegated to the bookkeeper. The work of the one should be separated from the work of the other whenever the volume of business warrants such separation. This may not always be practicable in a small concern.

Opening of Mail and Recording of Receipts.—All mail should be opened by or under the supervision of, a person other than the cashier or the bookkeeper—possibly in the presence of one or two others—and a record should be made of the remittances at the same time. All receipts will be listed on a cash remittance sheet or slip, an illustrative form of which is given on page 4. This form provides columns for the name of the remitter, the number of the account to be credited, and the total amount remitted. It also provides columns for distributing the total receipts into classes, according to the character of the receipts—checks, money orders, currency, and drafts. A separate column is provided for notes which are accepted as good. The cash sheet will contain other details concerning the remittances, as the cash discount taken and other deductions and claims. There will be

LEWIS MANUFACTURING COMPANY INC. — DAILY RECORD OF — NO. 100

NO. 100 ________ 19__

________ BANK

CREDIT ACCOUNT OF LEWIS MANUFACTURING CO.

	ACCOUNT NO.	FROM WHOM RECEIVED	CK.	M.O.	CASH	DRAFT	TOTAL	CUSTOMERS' NOTES GOOD		SUNDRY		CURRENCY	CHECKS ON CHICAGO	CHECKS OUTSIDE CHICAGO
1											1			
2											2			
3											3			
4											4			
5											5			
6											6			
7											7			
8											8			
9											9			
10											10			
11											11			
23											23			
24											24			
26											25			
27											26			
27											27			
28											28			
29											29			
30											30			
31											31			

Cash Remittance Sheet with a Detachable Bank Deposit Slip as many cash sheets as there are customers ledgers, one being prepared for each ledger. When cash is received, not from a customer, but as the result of some special transaction, as the sale of a building, scrapped machinery, or some other fixed asset, the account to be credited may be indicated on the cash sheet, or the remittance may be entered directly in the cash receipts journal.

The cash sheet is made out in duplicate or triplicate. One copy is kept by the person who has entered the cash items upon it, one is sent to the cashier—the receiving cashier, if the general cashier's function is divided between a receiving and a disbursing cashier—who enters the amount in the cash receipts book, and the third copy is routed for entry to the bookkeeper in charge of the particular customers ledger to which the cash sheet relates. The credits to the ledger are made directly from the cash sheet. On the other hand, only the total of each cash sheet is entered daily by the cashier in the cash book. By this method the cash receipts journal is relieved of detailed entries. The cash sheets should be preserved in a binder since they constitute the detailed record.

The cash remittances are attached to the copy of the cash sheet that goes to the cashier. If more than one bank account is kept, these remittances are then arranged according to the banks in which they are to be deposited. A simpler practice, however, is to deposit the total receipts of one day in one bank, and the total of the next day in the other bank, and so on. The cashier prepares in duplicate one or more deposit slips as called for, the originals of which go to the banks while the duplicates are retained. A check on the accuracy of the deposit slips is furnished by comparing their total with that of the cash sheet.

Proper Scrutiny of Cash Items Received.—Before listing cash receipts on the cash sheet, they should be carefully examined to see that they are in order and acceptable in payment of the invoice or account in question. Checks, for example, should be scrutinized for their date, signature, and the amount as written in figures and spelled out. Cash is not infrequently received where the remitter fails to state with sufficient clarity for whose account the remittance is made. In such cases the cash is deposited in the usual way, but until it is ascertained by further correspondence whose account is to be credited for the amount, such receipt may be credited to a temporary suspense account, entitled "Customers' Credit Balances," or bearing some similar name sufficiently indicative of the nature of its content. Credit to this account will be shown on the cash sheet. When the account to be finally credited is known, a journal entry is made, debiting "Customers' Credit Balances" and crediting the particular account.

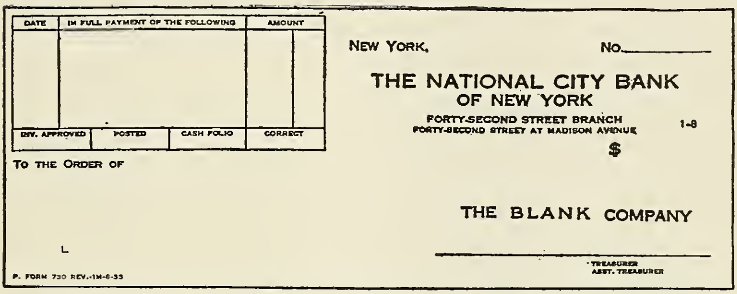
Items are also received about which there is some dispute. A customer may send a check with a notation that it is in full settlement of an invoice or an account, but the firm may refuse to accept it as such. In that event, the item is not entered in the cash sheet nor deposited, but is kept with similar items in a separate file in the safe, until some adjustment of the disputed matter is reached. Meanwhile, only a memorandum record is made of the item. Another method of treating such cash items is to handle them in the usual way and credit them to a temporary suspense account bearing a title which would clearly show the somewhat doubtful character of the cash items as assets of the firm.

HANDLING CASH DISBURSEMENTS

Various Procedures in Entering—Canceled Checks—Cash Payment Requisition—Disbursements under Voucher System

Check as Basis of Entry.—Modern practice makes the bank check the most acceptable means of disbursing cash. The exception to this general rule covers the disbursements made out of the petty cash fund. This fund, however, is controlled, under the imprest fund system, by periodically reimbursing the petty cashier with a check for the total disbursements of the period just elapsed. (See page 109.)

The check itself, or the check stub or interleaf in the check book, provides the basis for the entry in the cash disbursements journal (or check register). Where the voucher sys-



Form of Voucher Check Showing Entry of Its Amount on the Books Before It Is Signed

tem is in use, the voucher check is the basis of the entry in the cash disbursements journal as well as of the entry in the voucher register. In some instances, the carbon copy of the check and the remittance advice attached to it, listing the particular invoices being paid, with discounts and other deductions shown, furnishes the authority for the formal entry in the cash disbursements journal. The check may then be mailed immediately without waiting until the entry for the disbursement is made. The checks are usually entered in the cash disbursements journal in numerical order according to the check numbers. This method will indicate the cash balance on hand after all checks have been drawn. In a particular system or case when the check or its carbon copy cannot be used for entry, some other paper will serve as the authority or basis of entry, such as the receipt for money paid, the receipted invoice, the canceled promissory note when paid, etc.

In many concerns the check is signed by the proper corporate officer or officers only after entry of the disbursement has been made on the books. The purpose of this procedure is to insure the prompt recording of all disbursements and to minimize the danger of having the balance of the cash account represented larger than it in reality is, because of the failure to record all disbursements. The fact that a disbursement is entered on the books is shown on the face of the unsigned check when it is presented to the corporate officers for their signatures, in a space especially provided for the purpose, as illustrated in the voucher check form shown herein. If the check when presented for signature should be canceled, a reverse entry is made in red in the cash disbursements journal, with a cross-reference in the explanation column to the previous entry. The canceled check is marked "canceled" and filed with the checks that have been issued, paid and returned by the bank. When summarizing the cash disbursements journal for posting, the amounts entered in red should be deducted from total and only the balance posted to Cash.

Authorization of Disbursements.—Authority for disbursements covering accounts payable should originate in the accounting department or in the accounts payable unit of a large accounting department, and the amount of the remittance called for should be approved by the accounting head, who may be the controller. The accounting head will have prepared and will approve a remittance advice, as shown in the accompanying form, which will set forth the deductions from the amount in the creditor's statement so as to arrive at the net amount remitted. Such a form may be used in lieu of the voucher check. On the reverse side of the carbon copy of this remittance advice there is found a creditor's reconciliation statement as shown, which reconciles the balance shown in the accounts payable ledger with the amount of the remittance. These forms will then be passed to the

CREDITOR'S SETTLEMENT

NAME Federal Engineering Co. DATE 6/5/--

ADDRESS Detroit, Mich. STATEMENT DATE 6/1 BAL. 420 75

ALL DEDUCTIONS DETAILED BELOW

a

	Reference	Amount	Reference	Amount	Reference	Amount
a	78553	12 50				
a	78968	12 00				
		24 50				

Deductions:	
A R.M.D.s and D.M.s	24 50
B Excess R.M.D.s and D.M.'s over Creditor's C.M.'s	
C Payments	
D Overpayments	
E ____	
Total X.Y.Z. Co. Items	
F No Invoices (SEND COPIES)	
G Rec'd too late	
H ____ Total Deductions	24 50
I Net O.K. for Payment	396 25
J Discount: 2% Per. on ____	7 93
Remittance	388 32

Check No. 6741-BT

PAID JUN 10 19-- X. Y. Z. CO.

We reserve the right to recharge your account to cover errors, overcharges, Shortages and other items not approved by us during subsequent audits of your invoices, and accompanying check is tendered in payment of the above statement, subject thereto.

X. Y. Z. CO.

RECONCILIATION BY EK

H

Reference	Amount	Reference	Amount
Cm 2097	1 50		

	DEBITS	CREDITS
A X.Y.Z., Co. Ledger Balance at 6/1		397 75
Add to both Drs. and Crs. Unpaid Invoices not on Ledger		
B No Invoice		
C ____		
Add to Crs. only (Details below) Paid not on Ledger		
D Invoice posted in ____		
E ____		
Add to Drs. (Details below)		
F Creditors C. M.s not covered by our D. M.s		
G Invoices posted, but not approved		
H X.Y.Z., Co. Led. Creds. not charged by cred'r	1 50	
I Our payments not posted		
J Net O.K. for Payments (C. S.)	396 25	
K Over Remittance		
L Total (Drs. and Crs. must agree)	397 75	397 75

Reference	Amount	Reference	Amount	Reference	Amount

Creditor's Settlement Advice and Creditor's Reconciliation cashier's department, which is responsible for the preparation of checks and their entry in the cash disbursements journal or the check register. Where two or more bank accounts are kept, the account to be drawn on will be determined from the balances as shown by the cash receipts and cash disbursements journals.

Signing of Checks.—The responsibility for disbursing funds, that is, signing checks, for routine transactions after they are properly approved, is commonly assigned to a subordinate officer in large organizations. He may be the cashier or an assistant treasurer. In a small organization the treasurer makes the disbursements. Sometimes the cashier is authorized to draw checks for sums not in excess of a certain amount, while over that amount checks must bear the signature of the treasurer or assistant treasurer. Counter or additional signature is an added safeguard. The first signature is usually made by president, treasurer, or assistant treasurer; the counter-signature by vice-president, controller, or secretary. Although counter-signatures are desirable, these will not in themselves prevent forgery, since both signatures may be forged. Neither will they prevent errors from carelessness, if one signer relies on the other, thus making his signature a perfunctory matter. When the check has been completely signed, it is ready for entry in the cash disbursements journal, if that system is followed.

A "request for check" or a "cash payment requisition" form as given, requiring the approval of the financial manager, may be used to authorize disbursement cashiers to draw checks for other purposes, such as notes and acceptances payable, payrolls, dividends, investments, advances for traveling expenses, petty cash reimbursements, etc. Such requests may be in memo form, but should be prepared and signed in the first instance by departmental chief clerks, chief paymasters, general ledger bookkeepers, and even officials whose

CASH PAYMENT REQUISITION

$________.__

DATE__________19__

CHECK NO.__________

CASH BOOK FOLIO________

TREASURER,
PAY TO ____________________

ACCOUNT CHARGED	REQUESTED BY	DEPARTMENT
	SIGNED	APPROVED

Form of Requisition for a Cash Payment

position and whose knowledge of, and responsibility for, the correctness and propriety of such payments justifies the requirement that they sign such requests before being sent to the financial manager for the latter's approval and issuance of the checks. These requests should be specific and give ample details in addition to the name of the payee and the amount. Requests for checks covering notes or acceptances payable should specify the numbers and maturities of the instruments; those covering payrolls should be certified to by the chief paymaster; those covering petty cash reimbursements should require the signature of the auditor or designated clerk who has audited the vouchers, and the summary entered on envelopes containing them; those authorizing large traveling expense advances to be made by check should be signed by the various department heads; and those issued in connection with dividend and investment disbursements should be signed by the treasurer. The financial manager should, of course, exercise discretion in handling these requests, not hesitating to demand further information in cases of doubt, and even requiring copies of directors' resolutions, certified to by the secretary, or even the production of the directors' minute book itself, where the nature of the transactions indicate the desirability of such action.

Authority for Disbursements under the Voucher System.—Where the voucher system is used in its entirety, no check is drawn, for whatever purpose, unless a corresponding voucher is prepared. In this manner unusual disbursements can be readily verified in a routine way. In addition, one of the best controls of all cash disbursements is effected. The voucher check that may be used in making the disbursements under such a system will provide an itemized statement either on the face or the back of the check, but the ordinary check with a remittance advice may be found more adapted to particular needs.

HANDLING STAMP RECEIPTS

Placed in Petty Cash Fund—Delivery to Mailing Department

Stamps received as remittances from customers may be placed in the petty cash fund by the petty cashier "buying" the stamps, precisely as though he purchased them from the post-office. The cash he surrenders for them becomes a part of the daily deposits made in the bank. The petty cashier can from time to time deliver the stamps to the mailing department and secure that department's postage requisition or petty cash voucher for the cash value of the stamps turned over. If the amount of stamps received daily is large, a check can be drawn reimbursing the office cashier for the amount of the stamps authorized by the postage requisition.

EXCHANGE OF CHECKS FOR CURRENCY

Making Entries for Exchanges—Cashing Checks Out of Petty Cash

Exchange of Check for Currency.—A concern at times receives requests from persons, who desire to mail a remittance, to exchange its check for currency. The entry of such exchange is best made on both debit and credit side of the cash book by a charge to an account called "Exchange," with a reference "contra" added in each case to show the self-balancing nature of the record, though neither entry need be posted to the ledger. This makes the cash book record check against the bank record and shows the full history of the transaction.

Exchange of Currency for Check.—When a check is cashed in currency or when a check for a larger amount is received in payment of a debt and the difference is returned in cash, no record need be made of the check, as only the nature—not the amount—of the deposit for the day is changed and no disbursement is made which affects the bank account. When, however, a check is issued as "change" in lieu of currency, record should be made, debit and credit, as explained.

Cashing of Checks Issued to Employees.—When checks are issued to employees to cover expenses personally incurred by them on behalf of the company, and the checks are returned to be cashed by the company out of the petty cash fund, they are deposited in the bank in the usual routine and a petty cash voucher is made out for the amount of the disbursement, which is retained by the petty cashier until the petty cash fund is replenished.

CASH HELD AT BRANCHES

Deposits in Local Bank by Branches—Segregation of Operating Funds and Collections—Control of Branch Funds

Remittances to Head Office.—Regular remittances are usually made to the head office from all affiliated or controlled sources receiving cash, whether these sources are factories, branch sales offices, or affiliated companies. When the amounts involved are of some size, daily remittances may be made to the head office or may be deposited in a local bank to its credit. Remittances by branch offices to the head office are generally made at least semi-monthly. A consecutively numbered form of remittance or collection slip is used to simplify the record in the offices at both ends of the transaction and to make easier the verification of cash in transit whenever this is necessary.

Branch Bank Accounts.—Wherever a branch or affiliated company may be located, all daily receipts are preferably deposited in the local bank account. The cash not yet remitted to the head office is thus always on deposit in the local bank account of the branch or affiliated company. To control cash at branches making their own local collections, each branch may have a separate "operating" bank account as an imprest fund to be replenished at regular periods by check from the head office to cover branch expense reports. All branch collections are then deposited in a separate "branch collections" bank account against which are drawn only such checks as are remitted to the head office. Only the head office may draw checks against such "branch collections" bank account. When this is done, the local bank account at the point where the branch is located becomes in reality a head office bank account, and it is then necessary to treat all branch deposits in such bank account as if they were direct remittances to the head office, and make entries accordingly on the records both at the branch and at the head office.

Certificates of balances from local banks covering the "operating" bank account of branch offices are required by the head office at least monthly. In some cases, and always when the separate "branch collections" bank account is used, the monthly bank statements and the canceled checks are sent to the head office direct by the local bank.

All local bank accounts of branches may be deposited under arrangements which permit withdrawal by designated executives of the head office as well as by the properly authorized persons at the branch. Such arrangement prevents embarrassment in case of unforeseen circumstances occurring at the branch.

Intercompany Cash Transfers.—Where transactions between affiliated companies are many, a current controlling account will be kept with each company on the general ledger, and additional detailed accounts of the various classes of transactions may also be provided even to the extent of a separate "Cash Remittance" and "Cash Received" account with each company. Transfers of the total of the monthly entries in such classified accounts should be made to the controlling general ledger account summarizing all the transactions with the company.

The controlling company will receive regularly detailed statements from each affiliated company, for comparison with the head office ledgers. The use of separate accounts for intercompany outgoing remittances and incoming receipts simplifies the auditing of the general ledger controlling account with the affiliated company and enables identification to be made of items in transit at the close of a month. This practice also enables an auditor to compare elapsed time between original remittances on either side and the dates upon which the funds reach their destination, and puts him quickly upon the trail of any shortages which are being made good from subsequent transactions.

DAILY PROOF OF CASH

Daily Cash Summary—Count of Cash—Proof Against Check Record and Cash Book

Procedure in Verification.—The cash book is supposed to be a complete record of all cash received and expended and the balance of cash on hand and in the bank. In practice, however, errors creep in, and it is therefore advisable that the amount of cash on hand as verified by actual count and the amount in the bank as shown by the check record, be proved against the amount called for by the cash book. In making the proof, a simple procedure is that shown by the following form:

Daily Cash Summary

Date

1. Old balance in cash book	$1,500.00
2. Plus the total receipts	400.00
3. Equals total cash	$1,900.00
4. Less total disbursements	650.00
5. Equals present cash balance	$1,250.00

Verification

A. Balance in bank per check book		$1,077.25
B. Plus cash in the office:		
1. In cash register or till	$ 47.75	
2. In safe	125.00	172.75
C. Equals present balance in cash book		$1,250.00

If all cash receipts are deposited daily and all payments are made by check, the balance of the check record should equal the balance in the cash book.

Counting Cash for Verification.—In counting cash on hand at the close of each day, use of a form similar to that given below will aid in making an accurate count. The cash should be sorted by denominations, and the number of coins

CASH ON HAND

January 21, 19—

Denomination	Number	Amount
Currency		
$100	–	–
50	–	–
20	–	–
10	–	–
5	–	–
1	–	–
Coin		
.50	–	–
.25	–	–
.10	–	–
.05	–	–
.01	–	–
Checks		
Name		
–	–	–
–	–	–
–	–	–
–	–	–

Cash Verification Slip

or bills of each denomination should be entered on the form together with their total amount. Any undeposited checks should also be listed on the form.

CASH SHORT AND OVER

Entries for Shortages and Overages—Closing Out Cash Short-and-Over Balance

An actual count of the cash on hand should be made frequently and compared with the balance shown in the cash book. In most concerns cash inventories are taken at relatively short intervals, often from day to day. If the cash book record does not agree with the actual amount of cash on hand, it is necessary to bring it into agreement with the actual cash on hand.

Shortages.—If there is a shortage in the cash as compared with the cash book balance, an entry for the difference is made in the cash disbursements side of the cash book, with an appropriate explanation. When the posting of the entry is made, the amount is charged to "Cash Short and Over," or an account with some similar designation, while Cash is credited. Since, in order to determine the balance of cash in the cash book, the total of the cash disbursements side is subtracted from the total of the cash receipts side, the inclusion of the item as a disbursement will make the balance of the cash book less by the amount of the discrepancy and thus bring it into agreement with the actual cash on hand.

Overages.—It sometimes happens that instead of being short the cash is "over," meaning that the actual cash count shows a larger amount on hand than the cash book record calls for. To make the cash book agree with the count of cash, more cash must be shown on the record as having been received. Hence, it is necessary to enter in the receipts side of the cash book the amount of the difference between the cash actually on hand and the amount shown by the cash book. In posting, this amount is debited to the Cash account in the ledger, while the corresponding credit is posted to "Cash Short and Over."

Disposition of Cash Short-and-Over Balance.—When the balance of the "Cash Short and Over" account is small or when the items posted to it have in the main been small, it is customary to treat the account as a profit and loss account, and therefore to close it out when the profits and losses are summarized at the end of the fiscal year. If it contains a debit balance, denoting more shortages than overages during the period, the account is closed out by crediting it with the amount of the balance and debiting Profit and Loss. If an "over" or credit balance is shown, the closing of the account consists of debiting it with the amount of the balance and crediting Profit and Loss.

Discovering Cause of Discrepancy.—Although the cash book is easily adjusted by charging or crediting the Cash Short and Over account whenever the cash is short or over, the bookkeeper should realize the seriousness of errors which cause a difference in cash, especially cash shortage. The Cash Short and Over account should be merely a temporary makeshift to bring the book records into agreement with the cash count, and the error should be located as soon as possible. Otherwise, if no further attention is paid to the account, there will be a temptation to use it in covering up carelessness or fraud. After doing his regular work, therefore, the bookkeeper should exert every effort to find the error, and upon its discovery he should at once make the necessary counter adjusting entry canceling the previous one. By this method the balance in "Cash Short and Over" will be eliminated, or at least kept down to a nominal figure.

A shortage of cash in the drawer may come about in various ways, aside from actual pilfering. Where cash is handled carelessly, a practice may be made of taking cash from the cash drawer for small purchases or to pay small bills. Unless a record is made of these expenditures, the bookkeeper has no basis for recording the items in the cash book. Again, in making change for customers, more cash may be returned to the customer than should be. Overages usually occur in much the same way as shortages. Errors in making change where not enough cash is given to the customer, and the placing of cash in the cash drawer without recording its source, are the usual causes. Restaurants, motion picture theaters, and similar business organizations having several cashiers expect "Cash Short and Over" discrepancies to occur with a certain amount of regularity and accordingly provide special columns for these items in the cash book.

STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS

Form and Arrangement of Statement—Statements for Various Periods of Time

As Aid in Controlling Current Finances.—Statements of cash receipts and disbursements in various forms are prepared for the president or treasurer of the company in order to enable him to control the situation with respect to financing of current operations. These may be daily, weekly, monthly, and yearly. The statement of cash receipts and disbursements is in reality a summary or analysis of the cash book and wherever possible the columnar arrangement of the cash book should conform closely to the items of information shown on the statement. It will then be a comparatively simple matter to total the columns and insert the figures on a printed statement form.

Form of Statement.—A simple form of daily cash report, showing the cash balances on the first of the month, the total receipts of the month to date, and the day's receipts and disbursements, and the bank balance, is given opposite. Another form of statement, which may be used to report the daily, weekly, monthly, or yearly receipts and disbursements is also shown on page 21. A more elaborate statement that may be used with special advantage for the longer periods, as a month or a year, appears on page 22. This form is of particular assistance to the treasurer in the preparation of the cash budget. The information contained in such a report is secured from a variety of sources. A composite summary of the monthly cash statements may be used or an analysis of the posting to the ledger accounts may be made on a recapitulation sheet.

DAILY CASH REPORT

Date____________ 19____

Balance—1st of Month....................		$ –
Receipts—Today and Month to Date......	$ –	–
Cash Sales, Accounts and Notes Rec.....	$ –	
Borrowings..........................	–	
Miscellaneous.......................	–	
TOTAL...............		$ –
Disbursements:		
Accounts, Acceptances, and Loans Payable	$ –	
Payrolls............................	–	
Book Postage—Circular, Shipping, etc...	–	
Customers' Checks Returned...........	–	
Miscellaneous.......................	–	
TOTAL—Today and Month to Date.....	$ –	–
Bank Balance:		
National City Bank..................	$ –	
Chase National Bank.................	–	
TOTAL...............		$ –

Form of Daily Cash Report Submitted to President or Treasurer

STATEMENT OF RECEIPTS AND DISBURSEMENTS
For Week Ended May 28, 19–

RECEIPTS:		
Cash Sales	$10,129.40	
Accounts Receivable	25,464.50	
Notes Discounted	1,500.00	
Miscellaneous: Interest, Rebates, etc..........	519.20	
Total this week..........................	$37,613.10	
Previous Balance	2,319.40	$39,932.50
DISBURSEMENTS:		
Accounts Payable	$28,492.10	
Salaries and Wages..........................	4,193.25	
Delivery Equipment	250.00	
Advertising	1,300.00	
Miscellaneous: Interest, General Expense, etc.	920.15	35,155.50
Balance on Hand, as per cash book..................		$ 4,777.00

Statement of Receipts and Disbursements

Statement of Receipts and Disbursements
For Year Ended December 31, 19–

Cash Balance, January 1, 19—:			
On Hand		$ –	
In Banks		–	$ –
Receipts			
Collections:			
Customers' Accounts	$ –		
Claims against Common Carriers	–		
Notes and Loans, including interest	–	$ –	
Sale of Assets:			
Materials and Supplies Sold to Employees	$ –		
Containers	–	–	
Liabilities Incurred:			
Notes and Loans	$ –		
Deposits by Employees	–		
Credit Accounts of Officers	–	–	
Miscellaneous Sources:			
Insurance Premiums Refunded	$ –		
Dividends on Material Insurance Policies	–		
Miscellaneous Refunds	–	–	
Total Receipts			–
			$ –
Disbursements			
Liabilities Retired:			
General Creditors	$ –		
Employees' Payrolls	–		
Notes and Loans	–		
Bonds	–	$ –	
Interest on Indebtedness		–	
Officers' Drawings Against Credit Accounts		–	
Transportation Charges on Materials		–	
Factory Overhead Expenses:			
Automobile Expense	$ –		
Warehouse and Delivery Charges	–		
General Factory Expense	–		
Miscellaneous Shipping Expense	–	–	
Selling Expenses:			
Salaries and Commissions of Salesmen	$ –		
Advertising	–		
Special Jobbers' Commissions	–	–	
General and Administrative Expense:			
Salaries	$ –		
Postage	–		
Telephone and Telegraph	–		
Traveling Expense	–		
Legal Expense	–		
Miscellaneous	–	–	
Total Disbursements			–
Cash Balance, December 31, 19—			$ –
On Hand		$ –	
In Banks		–	
		$ –	

Statement of Receipts and Disbursements

BUSINESS PAPERS REPRESENTING CASH RECEIPTS

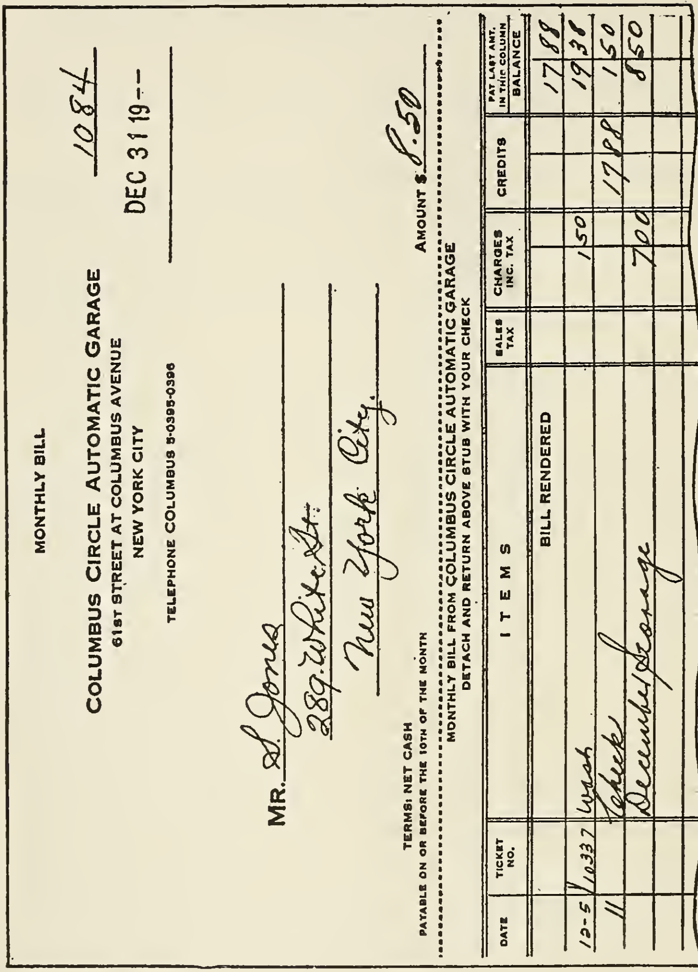
Purposes Served by System of Paper Work—Receipts from Cash Sales—Remittance Slips

System of Paper Work.—The system of paper work in connection with the receipt of cash serves four chief purposes:

1. It furnishes a basis for formal entry in the books.
2. It is so organized as to safeguard the cash, thus preventing theft and loss.
3. It serves as a basis for internal reports to executives.
4. It places responsibility for the cash.

Sources of Cash Receipts.—Cash receipts come from various sources, among which are: (1) original investment by owner; (2) sales of merchandise for cash; (3) collection of customers' accounts; (4) notes payable and receivable discounted at bank; (5) interest, commissions, rentals, etc., i.e., earnings of all kinds; (6) the sale of securities, fixed assets, etc. In some of these cases the cash received is evidenced by a business document or paper, in others not. The cash sales ticket, the cash register record on the tape, the customer's letter with check enclosed, the receipt issued to the payer, letter of notification from the broker or agent of amounts received from sale of assets other than merchandise—all these comprise the business papers supporting the receipt of cash.

Handling Cash Receipt Memos.—In the retail store, cash sales usually constitute the largest source of cash receipts. Where sales are evidenced by sales tickets, the total of the tickets checked against the count of cash provides the basis for entry in the cash receipts journal as well as in the sales journal. Similarly, where cash registers are used, the "readings" taken at the close of each day's business, after being entered in a memo book or register, provide the basis for formal entry in the cash journal.



MONTHLY BILL

COLUMBUS CIRCLE AUTOMATIC GARAGE
61ST STREET AT COLUMBUS AVENUE
NEW YORK CITY

TELEPHONE COLUMBUS 5-0395-0396

1084

DEC 31 19--

MR. S. Jones
289 White St.
New York City.

TERMS: NET CASH
PAYABLE ON OR BEFORE THE 10TH OF THE MONTH

AMOUNT $ 8.50

MONTHLY BILL FROM COLUMBUS CIRCLE AUTOMATIC GARAGE
DETACH AND RETURN ABOVE STUB WITH YOUR CHECK

DATE	TICKET NO.	ITEMS	SALES TAX	CHARGES INC. TAX	CREDITS	PAY LAST AMT. IN THIS COLUMN BALANCE
		BILL RENDERED				17 88
12-5	10337	Wash		1 50		19 38
11		Check			17 88	1 50
		December Storage		7 00		8 50

Customer's Monthly Statement with Detachable Cash Remittance Slip

Cash collected from customers on account is usually received in the form of the customer's check which thus suffices for entry in the cash journal. When mailed in any other form, the letter of transmittal will usually serve as a sufficient memo for formal entry. When cash is delivered in person by the customer, a cash memo ticket bearing customer's name and amount, or a duplicate receipt blank, if a formal receipt is given the customer, or immediate entry on a cash sheet will provide the basis for formal entry. Entry on the cash sheet may itself be sufficient formal entry, where such sheet is later made to comprise a page of the cash receipts journal. Other cash receipts are usually evidenced by cash memo tickets, by memo or report from the bank, sales confirmation from the broker, or other similar means.

Remittance Slips.—When mail receipts are accompanied by the regular remittance forms comprising the top of the customer's monthly statements (see accompanying form), the checks and the remittance forms or slips are delivered at once to the cashiers. The cashiers should take charge of the cash. When a large number of cash receipt items are handled, the remittance forms should be put through cash registering machines for appropriate stamping and registering the total daily receipts, before sending them to the bookkeepers in the accounts receivable department. Forms similar to the top of the customer's monthly statement should be prepared for remittances from customers which were not accompanied by such forms. In the same manner, remittance slips should be prepared for receipts accompanied solely by letters. After the preparation of such slips, the letters and other data may be sent to the various departments interested in matters referred to in the correspondence. All remittance slips go to the accounts receivable unit for posting to the credit of the respective customers' accounts.

CASH BOOK AS A DETAILED CASH ACCOUNT

Cash Book Handled as Ledger Account—Disadvantages of Practice

The cash book, so far as balancing and ruling are concerned, is handled like a ledger account. Hence, the cash book, in addition to comprising two special journals, may also serve as a detailed cash account, the receipts side being the debit side of the account, and the disbursements side the credit side of the account. This induces some businesses to omit the cash account from the ledger as an unnecessary duplication. This, however, makes the ledger record incomplete and out of balance, so that when taking a trial balance the cash balance, secured from the cash book, must be added. It is better bookkeeping practice, therefore, to make use of a cash account in the ledger, to which will be posted weekly or monthly the totals of the summary entries in the cash book, and so make the ledger a complete final record of all transactions.

BALANCING AND RULING THE SIMPLE CASH BOOK

Method Illustrated—Forwarding Balances of Cash Book

Form of the Cash Book.—In small organizations, for convenience in watching the inflow and outgo of cash, the record of both receipts and disbursements may be made in the same book, which is called the cash book or cash journal. The receipts and disbursements are made on facing pages, the receipts on the left-hand pages—pages 2, 4, 6, etc.—and the disbursements on the right-hand pages—pages 3, 5, 7, etc. The record of cash receipts and cash disbursements is kept in separate bound volumes in larger concerns where greater subdivision of clerical work is necessary.

Balancing and Ruling.—To show the amount of cash on hand at the end of a week or month, the cash book is balanced. The method illustrated here (pages 28-31) in connection with the two-column cash book may be explained as follows:

1. On the disbursements side on the line below the summarizing entry, "Cash, Cr.," enter the date, the word

"Balance" and in the second money column the difference between the total receipts and disbursements. It is sometimes written in red ink to indicate that it must be brought down on the cash receipts side, but red ink balancing is no longer deemed necessary in modern bookkeeping practice.

2. Rule single lines across the last money column on the receipts and disbursements sides and enter the totals on the next line. These totals on both the receipt and disbursement sides must be now the same.
3. Rule double lines across all money and date columns. The double ruling separates the current record from the record of the next week or month.
4. Enter the balance of cash below the double rulings in the second money column of the receipts side.

Frequently blank lines appear on one side or the other of the cash book because the number of transactions is not the same for each journal. If desired, these blank lines may be canceled by drawing a line diagonally across them.

Forwarding.—In the use of the cash book, it frequently becomes necessary to carry forward the total of cash receipts (or cash disbursements, as the case may be) from the bottom of one page to the top of another, as from the bottom of page 2, to the top of page 4. This is done by writing on the last line of page 2, "Forwarded to page 4," and the amount carried forward. This is then shown on the first line of page 4 under the title, "Brought forward from page 2," the amount appearing in the same relative column as on page 2. The carrying forward of cash disbursements totals is done in the same way. It is not customary to balance the cash book at the bottom of each page just because it happens to be the bottom; the balancing is done at regular periods. When the totals of one journal are carried forward to another page, it is not necessary to bring forward the totals of the other

2

Cash Receipts

Date		Accounts Cr.	Explanation	F	Items	Total
Apr. 19—	1	A.B Conrad c/a	investment		5000 —	
	7	John Jones	in full of account		500 —	
	14	Notes Payable	Merchants Bk. 30 das.		1000 —	
			note with int. at 6%			
	20	D.E. Fields	todays sale #37		700 —	
	30	Rent	J. Lowell ck. for		100 —	
			office rent for May			
	30	Notes Receivable	R. Norris for 30 das.		1000 —	
			note of 3/31/—			
	30	Interest	30 days at 6% on above		5 —	
	30	Cash, Dr.				8305 —
						8305 —
Apr.	30	Balance				6438 25
May	1	Martin & Jackson	cash sale #25		450 —	
	5	Irwin & Swazey	on a/c		1000 —	
	12	Notes Receivable	H.H. Blies for his		500 —	
			30 day interest bearing			
			note of 4/12			
	12	Interest	30 days at 6% on above		2 50	
	15	Furniture & Fix	sold filing cabinet		20 —	
	20	John Hendricks	on account		100 —	
	22	John Jones	cash sale #45		125 60	
	23	Land & Buildings	C.F. Hill for part		500 —	
			payment on Lots #27			
			28-29 Block 12 total			
			$5,500 subject to			
			mortgage of $5,000			
			see J. page —			
	27	D.E. Fields	sale #54 $200 less 2%		196 —	
	27	Forwarded to page 4			2894 10	6438 25

Cash

Cash Disbursements 3

Date		Accounts Dr.	Explanation	F	Items	Total
Apr. 19	4	Furniture & Fix	J. Smith & Co. office desk		150 —	
	7	Printing & Sta	Styles & Bro. bill of 4/7		63 75	
	12	Joseph Webster	ck for inv. #9 $500		495 —	
			less 1% (See J. page—)			
	16	A.B. Conrad, %a	for personal use.		100 —	
	20	Expense	cleaning floors & windows		5 —	
	27	Bates & Co.	cash purchase #18		450 —	
	30	Notes Payable	Ross Bros for our		600 —	
			30 day note of 4/1/—			
			with int. $600			
	30	Interest	30 days at 6% on above		3 —	
	30	Cash, Cr.				1866 75
	30	Balance				6438 25
						8305 —
May	1	Office Salaries	Bkpr $150. Steno $125.		375 —	
			Clerk $100.			
	3	H.B. Wright	in full of account		920	
	6	McKesson & Roberts	ck. for inv #14 $900		882 —	
			less 2% (See J page —)			
	14	Notes Payable	Merchants Bk. for		1000 —	
			30 days note of 4/14/—			
	20	Advertising	bill of Evening Star		75 —	
			for month of Apr.			
	29	Joseph Webster	on account		300 —	
	29	Fr. & Ctge. In	Penn. R.R. for frt.		49 70	
			on inv. #19			
	31	Forwarded	page 5		3601 70	

4

Cash Receipts

Date		Accounts Cr.	Explanation	F	Items	Total
19— May	27	Forwarded	from page 2		2894 10	6438 25
	31	Rent	J. Lowell for June office rent		100 —	
	31	Cash, Dr.				2994 10
						9432 35
May	31	Balance				5830 65
June	1	John Hendricks	Sale #63 $400 less 2% See J page—		392 —	
	4	Irwin & Swazey	on account		200 —	
	6	Young & Co.	Sale #66 $300 less 1% See J page—		297 —	
	10	Martin & Jackson	on account		150 —	
	12	Henry Bishop	cash sale #94		340 —	

Cash Book

journal unless the entries of that journal also fill the page on which they appear. A simple illustration of forwarding is included on pages 28-31.

SIMPLE CASH RECEIPTS JOURNAL

Columnar Arrangement of Journal—Rules for Posting—Alternative Procedures

Form of Cash Receipts Journal.—On page 32 is given a simple cash journal, ruled up to provide columns for date of entry, the account to be credited, certain particulars regarding the transaction (corresponding to the explanation in the general journal, if the transaction were entered there), the ledger folio, the amount to be credited in each transaction, the discount allowed in sale of merchandise, and finally the net amount received, which is to be deposited daily in the bank, if that is the customary practice of the particular business.

Cash Disbursements						5
Date		Accounts Dr.	Explanation	F	Items	Total
19 May	31	Forwarded	from page 3		3601 70	
	31	Cash, Cr.				3601 70
	31	Balance	on hand			5830 65
						9432 35
June	2	H. B. Wright	inv. #18 $300 less 3%		291 –	
			See J page—			
	7	Cash Short & Over	counterfeit bill		5 –	

(*Continued*)

Rules for Posting Summarized.—The following summarizes the rules for posting the cash receipts journal.

1. As to the *debit postings:*

   (a) No individual debit postings are made currently during the month, but the amounts of actual net cash receipts are entered in the bank column of the cash receipts journal, and discounts allowed on sales in the discounts on sales column, with the total in the credit column.

   (b) At the end of the month, the bank column is footed and the total is debited to the Cash account. The ledger folio for this posting is noted under the total. Similarly, the discount on sales column is footed and the total charged to Discount on Sales account, with the ledger folio for the account entered below.

2. As to the *credit postings:*

   (a) In each transaction other than a sale of merchandise involving the immediate receipt of cash, post the credit daily from the cash receipts journal to the proper account and enter the page number of the ledger in the folio column.

(b) In the case of a sale of merchandise in which there is an immediate receipt of cash, no credit posting is necessary from the cash receipts journal, inasmuch as the posting will be made from the sales journal where the transaction is also recorded. When the entry is made in the cash receipts journal, the fact that no posting is required should be immediately indicated by entering a check-mark (√) or a cross (x) in the folio column, or by a posting mark "SJ," showing that the credit posting is through the sales journal.

Instead of the foregoing procedure, the method is used at times of posting in full the entry in each journal as follows: The cash receipts journal entry—debit Cash account and credit Cash Sales account; and the sales journal entry—debit Cash Sales and credit Sales. By this procedure the Cash Sales account will always be in balance, so that the postings to it will not duplicate those made to the Sales account. The same method may be employed when the cash sales are entered in special columns in both journals and only the footings of the columns are posted.

19—	Account Credited	Explanation	L F	Cr. Amount	Dr. Disc. on Sales	Dr. Bank
Jan. 2	A. Brown, Capital	Initial Invest.	51	10,000 –		10,000 –
4	D. C. Tapp	Cash Sale	√	450 –		450 –
16	Mortgage Payable	Safety Mortg. Co.	63	1,000 –		1,000 –
21	J. B. Jones	Net due less 2%	75	400 –	8 –	392 –
25	Davis Supply Co.	On account	20	287 50		287 50
				12,137 50	8 –	12,129 50
					(93)	(1)

Simple Cash Receipts Journal

SIMPLE CASH DISBURSEMENTS JOURNAL

Form of Journal—Making Entries—Rules for Posting

Form of Simple Cash Disbursements Journal.—An example of a simple cash disbursements journal, in which a number of typical cash expenditures are entered, with one line devoted to each transaction, is shown below. The columns provided are for entry of the date of the transaction, for the number of the check by which the disbursement is made (in the simple form of disbursements journal this column is frequently omitted), for the account to be debited, for certain particulars regarding the transaction, the ledger page number of the account to be debited, if posting is to be made from this journal, the amount of the debit, the amount of the discount on purchases, and the individual amounts of the checks drawn.

19—	Ck. No.	Account Debited	Explanation	L F	Dr. Amount	Cr. Pur. Disc.	Cr. Bank
Jan. 2	1	Furn. & Fix.	Blank Mfg. Co.	6	200 –		200 –
4	2	Purchases	B. Peterson & Co.	√	500 –		500 –
13	3	Purchases	Less 2% dis.	80	120 –	2 40	117 60
18	4	Insurance Expense	1 yr. fire policy	84	108 –		108 –
29	5	J. Taylor & Co.	On account	65	450 –		450 –
					1,378 –	2 40	1,375 60
						(97)	(1)

Simple Cash Disbursements Journal

Rules for Posting.—The general rules for posting the cash disbursements journal are as follows:

1. As to *debit postings:*

   (a) All accounts, except in the case of cash purchases, are posted daily from the cash disbursements journal and the ledger page numbers on which they appear are entered in the folio column of the journal.

   (b) Cash purchases are not posted to Purchases account from this journal, but from the purchase journal instead, and this is indicated by the check-mark (√)

in the folio column, or by the letter "P" to indicate that the debit posting is from the purchase journal.

2. As to the *credit postings:*
   (a) No postings for the individual disbursements or for the cash discounts received on purchases are made during the month.
   (b) At the end of the month the "Bank" and "Discount" columns are footed and their totals are posted to the credit of Cash and Purchase Discounts, respectively, the ledger folios being indicated in the cash disbursements journal under the footings, as shown in form on page 33.

CHECK REGISTER

Contrasted with Form of Cash Disbursements Journal—Where Several Bank Accounts Are Used—Inclusion of Additional Columns

Form of the Check Register.—In a small enterprise the regular cash disbursements journal is used, providing columns for the following

1. Date
2. Check Number
3. Account to be debited
4. Particulars
5. Folio
6. General Ledger (debit)
7. Creditors Ledger (debit)
8. Discount on Purchases (credit)
9. Bank (credit)

In large establishments using the voucher system and makings all disbursements by check to liquidate audited vouchers, the disbursements journal becomes a more abbreviated record, and is referred to as the "check register." Provision made for certain entries in the voucher register will then obviate the need of some of the columns enumerated above as appearing in the disbursements journal, as follows:

(a) If discount on purchases appear in the voucher register, column 8 in the above list is not needed in the disbursements book.

(b) When all payments are charged to vouchers payable control which is the substitute for creditors ledger, column 7 above is not required. Hence, general ledger column 6 will not be used, and columns 3, 4, and 5 are also no longer needed.

(c) The amounts charged to vouchers payable control and credited to bank are identical. Hence, column 9 may be dropped.

After the foregoing changes are made there remain in the record of cash disbursements, columns for the date, check number, and a single column representing Bank, Cr. If a column is inserted for the voucher number, the check register will appear as shown below. There are no postings from this check register until the end of the month, when the total of the checks drawn is charged to Vouchers Payable control account (page 163 in the general ledger) and credited to the bank account (page 101 in the general ledger).

CHECK REGISTER

Date 19–	Ck. No.	Vo. No.	Amount		Date 19–	Ck. No.	Vo. No.	Amount	
5/3	1	3	$4,918	20	Forward			$10,285	13
Forward			$10,285	13	Total			$25,110	50
							Dr.	163	
							Cr.	101	

Simple Form of Check Register

Two or More Bank Accounts.—In case there is more than one bank account.

1. A separate check register is provided for each bank if there is a separate series of check numbers for each bank; or

2. Two or more money columns are provided in the same

THE PROGRESSIVE MOTOR COMPANY

CHECK REGISTER

SHEET NO. 1

AUTOMATIC AUDIT SHEET.

EFAD 6

AMOUNT PAYABLE	DATE	CH. NO.	AMOUNT OF CHECK	PAYEE	DISCOUNT EARNED CREDIT	DEBITS: GENERAL LEDGER ACCOUNT	GENERAL LEDGER AMOUNT	VOUCHERS PAYABLE	NOTES PAYABLE	NATIONAL BANK	PEOPLES STATE BANK
47 53	SEPT 10 1925	784	47 53	AMES WALKER	97			47 53		47 53	
24 38	SEPT 10 1925	785	24 38	BARNES & BIGG	37			24 38		24 38	
118 05	SEPT 10 1925	786	118 05	DAGGET BUMPER	2 41			118 05		118 05	
1038 75	SEPT 10 1925	787	1038 75	ANY MOTOR CO	0 00			1038 75		1038 75	
4 75	SEPT 10 1925	788	4 75	GLOBE DISPLAY	0 00			4 75		4 75	
8 77	SEPT 10 1925	789	8 77	GRANGER SUP	18			8 77		8 77	
93 56	SEPT 10 1925	790	93 56	HUDLEY MOTOR	94			93 56		93 56	
6 50	SEPT 10 1925	791	6 50	R L JACKSON	0 00			6 50		6 50	
11 27	SEPT 10 1925	792	11 27	J H MIDDLETON	23			11 27		11 27	
40 59	SEPT 10 1925	793	40 59	J L SAWYER CO	64			40 59		40 59	
221 90	SEPT 10 1925	794	221 90	VULCAN T & R	2 69			221 90		221 90	
1616 05			1616 05	TOTALS	8 43			1616 05		1616 05	

More Complex Form of Check Register

register, if there is only one series of check numbers, as in the following:

Date	Check Number	First State	City National
1	242	$ 25.10	$ –
3	243	–	122.85
3	244	–	12.75
5	245	725.00	–

Three adjacent columns may be provided for each bank account in the bank register to show the daily deposits, the disbursements, and the running balance. From such register a formal daily report for the treasurer can be made, showing: (1) balance at the beginning of the day; (2) the day's deposits; (3) total checks drawn; and (4) the current balance available in each bank account—very necessary information when many checks are being drawn daily.

More Complex Registers.—Check registers are not always in the abbreviated form shown on page 35, and may contain additional columns, depending upon the transactions which are not passed through the voucher register. Illustration of such a check register is shown on page 36.

Numbering of Checks.—Inasmuch as terms of credit extended by various vendors differ, the payment of the vouchers will not take place in the same chronological sequence in which they are recorded in the voucher register. Hence, these payments as entered in the check register will not follow the sequence of voucher numbers. It is best, therefore, to give the checks issued in payment of vouchers a series of numbers independent of the voucher numbers. If the method of using a check separate from the voucher is followed, this causes no confusion. If, however, a voucher check method is employed, the check will carry two numbers, the voucher number and its own check number. Entry in the voucher register is in accordance with the voucher numbers, while entry in the check register follows sequence of check numbers.

CASH RECEIPTS

Date		ACCOUNTS, Cr.	EXPLANATION	L F	General		Sales Discount		Net Cash	
19—										
Nov.	1	F. C. Hill, c/a	investment		3,000	–			3,000	–
	4	E. S. Kingsley	sale #3, less 2%		400	–	8	–	392	–
	10	Frank Harris	sale #10, less 2%		300	–	6	–	294	–
	17	Cash Sales	sale #17	√	40	–			40	–
	23	Notes Receivable	M. Carson for his 60 da. note of 9/24 with int.		600	–			606	–
	23	Interest Income	60 da. at 6% on above		6	–				
	28	John Dunn	sale #23, less 3%		160	–	4	80	155	20
	30	Munson & Co.	sale #24, less 2%		787	–	15	74	771	26
					5,293	–	34	54	5,258	46
	30	Cash			5,258	46				
		Sales Discount			34	54				
		General		√			5,293	–		
					5,293	–	5,293	–		
	30	Cash Receipts		√					5,258	46
									5,258	46
Dec.	1	Balance of Nov. 30	$1,393.61	√						
	1	Frank Harris	sale #21, less 2%		375	–	7	50	367	50
	17	E. S. Kingsley	sale, #40, less 2%		790	–	15	80	774	20
	20	Cash Sales	sale #42	√	82	–			82	–
	23	Howard & Smith	on account		500	–			500	–
	29	M. S. King	sale #45, less 2%		437	–	8	74	428	26
					2,184	–	32	04	2,151	96
	31	Cash			2,151	96				
		Sales Discount			32	04				
		General		√			2,184	–		
					2,184	–	2,184	–		
	31	Cash Receipts		√					2,151	96
	31	Balance of Nov. 30		√					1,393	61
									3,545	57
19—										
Jan.	1	Balance of Dec. 31, 19–	$1,519.67	√						

The Three-Column

CASH DISBURSEMENTS

Date		ACCOUNTS, Dr.	EXPLANATION	L F	General		Purchase Discount		Net Cash	
19—										
Nov.	2	Furn. & Fix.	United Fix. Co. Inv. of 11/1		300	–			300	–
	2	Rent	Duff & Brown for Nov.		200	–			200	–
	7	Howe Bros.	inv. #3, less 2%		1,000	–	20	–	980	–
	8	Freight In	N. Y. C. R. R. bills for wk.		72	25			72	25
	14	Martin & Co.	inv. #7, less 3%		900	–	27	–	873	–
	27	National Corp.	inv. #11, less 4%		1,260	–	50	40	1,209	60
	30	Salaries	clerks' for the month		230	–			230	–
					3,962	25	97	40	3,864	85
	30	General		√	3,962	25				
		Purchase Discount					97	40		
		Cash					3,864	85		
					3,962	25	3,962	25		
	30	Cash Disbursements		√					3,864	85
	30	Balance		√					1,393	61
									5,258	46
Dec.	2	Rent	Duff & Brown for Dec.		200	–			200	–
	7	Freight In	N. Y. C. R. R. for 3 wk.		277	–			277	–
	10	The Ralston Co.	inv. #14, less 2%		400	–	8	–	392	–
	12	Delivery Expense	1 bbl. gasoline 50 gal		11	–			11	–
	16	Howe Bros.	inv. #17, less 2%		200	–	4	–	196	–
	19	Adams & Drew	inv. #21, less 3%		250	–	7	50	242	50
	24	Notes Payable	R. Swift for our 60-day note of 10/23 with int.		400	–	}		404	–
	24	Interest Cost	60 da. at 6% on above		4	–	}			
	27	F. C. Hill, Dr.	for personal use		50	–			50	–
	31	Salaries	clerks' for the month		250	–			250	–
	31	Cash Short & Over	cash short		3	40			3	40
					2,045	40	19	50	2,025	90
	31	General		√	2,045	40				
		Purchase Discount					19	50		
		Cash					2,025	90		
					2,045	40	2,045	40		
	31	Cash Disbursements		√					2,025	90
	31	Balance		√					1,519	67
									3,545	57

Cash Book

THREE-COLUMN CASH BOOK

Columnar Arrangement of Book—Special Problems of Summarizing and Balancing

The use of the three-column cash book presents some special problems in summarizing, posting, and balancing. The reader should note carefully how these problems are handled in the illustration shown on pages 38-39.

Cash Receipts Journal.—This is prepared for posting or summarizing by first entering the totals of all columns and then arranging the totals in the form of a journal entry. The Net Cash and Sales Discount columns are debit columns and the General column is a credit column. The totals are arranged in the form of a journal entry in the first two money columns, as shown in the illustration.

Since each individual amount in the General column has already been posted at the close of each day to the credit of its respective account, the total of $5,293 appearing as a credit to General in the summary is checked (√) and not posted.

For convenience in posting and to prevent errors, the columns are arranged in the order shown so that each amount in the General column, which is posted, will be as close as possible to the name of the account in the Accounts Cr. column.

Cash Disbursements Journal.—This is prepared for posting (summarized) in the same manner as the cash receipts journal, except that General is a debit column and Cash and Purchase Discount are credit columns.

Balancing.—This serves two purposes: (1) to state the present balance of cash; and (2) to rule off the cash book and prepare it to receive the cash receipts and disbursements of the next period.

The manner of balancing the cash book should be studied carefully. It will be noted that the amount of the balance entered at the beginning of the month of December in the cash receipts journal is not extended into the money columns but is entered in the Explanation column. This is done to keep the balance brought forward separate from the cash items received during the current month.

SPECIAL-COLUMN CASH BOOK

What Determines Number of Columns—Cash Sales—Deposits Made in More Than One Bank—Proving and Closing

Additional columns may be introduced in the cash book for the purpose of segregating any particular kind of information desired and saving labor by posting to the control accounts in the general ledger the total of items of the same kind, in place of the detailed postings necessary when additional columns are not used. The addition of columns may be carried to any degree desired. It is a fundamental principle, however, that an additional column should be used only when transactions of a particular type occur frequently. The nature of the business, the different kinds of transactions, and therefore the kinds of information desired, usually determine the number of columns.

Additional Columns in Cash Receipts Journal.—An illustration of the special or multi-column cash book is given on pages 42-43. Not infrequently a special column is set aside for cash sales in the cash receipts journal, as in the present illustration. In such cases, care must be used in posting the totals of the columns at time of summary. As cash sales are usually entered in the sales journal and therefore included in the total credit to merchandise sales posted from that journal, the total of the cash sales column in the cash receipts journal should be checked (√) or marked "SJ," and not posted. The purpose of the column is simply to

CASH RECEIPTS

Date		ACCOUNTS Cr.	EXPLANATION	L F	General		Cash Sales		Sales Discount		Net Cash	
19—												
Aug.	1	Balance of July 31	$4.000–	√								
		Cash Sale	#47	√			300	–			300	–
	2	Notes Payable	Discounted our 60-day									
			notes at 1st Natl. Bk.		1,000	–			x10	–	990	–
	3	Cash Sale	#59	√			660	–			660	–
	12	Moore & Co.	sale #32, $800, less 2%		800	–			16	–	784	–
	15	Cash Sale	#72	√			375	–			375	–
	19	Brown & Co.	sale #85, $920, less 2%		920	–			18	40	901	60
	23	Notes Receivable	Ed. Smith for 60-day									
			note with int.		1,300	–						
		Interest Income	60-days at 6% on above		13	–					1,313	–
	27	Cash Sale	#91	√			530	–			530	–
	30	Cash Sale	#106	√			192	–			192	–
	31	Hoyt & Lee	on account		500	–					500	–
		Rogers & King	sale #103, $750, less 2%		750	–			15	–	735	–
					5,283	–	2,057	–	49	40	7,280	60
									x10	–		
	31	Cash			7,280	60						
		Sales Discount			49	40						
		Interest Cost			10	–						
		Cash Sales		√			2,057	–				
		General		√			5,283	–				
					7,340	–	7,340	–				
		Receipts		√							7,280	60
	31	Balance of July 31		√							4,000	–
											11,280	60
Sep.	1	Balance of Aug. 31	$4,846.15	√								

CASH DISBURSEMENTS

Date		ACCOUNTS Dr.	EXPLANATION	L F	General	Delivery Expense	Salaries	Purchase Discount	Net Cash
19—									
Aug.	1	Rent	Darwin & Hobbs for mo.						
			ending Aug. 31.		300 –				300 –
	3	The Ralston Co.	inv. #18, $1,200, less 2%		1,200 –			24 –	1,176 –
	5	Delivery Exp.	1 bbl. gasoline 50 gal.	√		11 –			11 –
	6	Salaries	clerks for week	√			90 –		90 –
	9	R. F. White	inv. #21, $900, less 3%		900 –			27 –	873 –
	10	Delivery Exp.	Owl Garage, repair bill	√		23 60			23 60
	12	Notes Payable	Prepaid our 60-day in-						
		Interest Cost	terest-bearing note of		2,000 –				
			6/13 favor C. E. Head		14 95				2,014 95
			Face $2,000.–						
			Int. 60 da. 6% $ 20.–						
			Dis. 15 " 6% 5.05						
			Net int. charge $ 14.95						
			Total $2,014.95						
		Salaries	Clerks for week	√			90 –		90 –
		Delivery Exp.	Chauffeur's wages 2 wks.	√		70 –			70 –
	15	Notes Payable	Prep. our 4 mos. note of						
			favor Todd & Co. $1,200.–		1,200 –			x12 –	1,188 –
			Less 2 mo. dis. 6% 12.–						
			Net $1,188.–						
	16	Delivery Exp.	Owl Garage, oil & repairs	√		14 90			14 90
	18	Salaries	clerks for week	√			90 –		90 –
	27	Reed & Co.	inv. #27, $400, less 3%		400 –			12 –	388 –
	30	Delivery Exp.	Chauffeur's wages 3 wks.	√		105 –			105 –
					6,014 95	224 50	270 –	63 –	6,434 45
								x12 –	
	31	General		√	6,014 95				
		Delivery Expense			224 50				
		Salaries			270 –				
		Purc. Dis.				63 –			
		Int. income				12 –			
		Cash				6,434 45			
					6,509 45	6,509 45			
	31	Disbursements		√					6,434 45
		Balance		√					4,846 15
									11,280 60

Cash Book

inform the manager of the business what amount of the total sales were made for cash.

Some concerns use the sales book for credit sales only. In that event, the cash sales column in the cash receipts journal is posted to the credit of the Sales account and the folio indicated.

In a business where all sales are cash sales, the use of the cash sales in the cash receipts journal will make unnecessary the use of a sales journal. In this case the total of the cash sales column will be posted to the credit of the Sales account in the ledger. In larger firms having accounts with more than one bank, in addition to the net cash column, there will be columns to show the deposits made in individual banks. Special columns commonly found in cash receipts journal are Sales Discounts, Cash Sales, Notes Receivable and Accounts Receivable.

Additional Columns in the Cash Disbursements Journal.—In the cash disbursements journal, columns may be added to show the various types of recurring disbursements. If there are many entries for the same kind of expense, a column may be headed with the title of that account. All disbursements affecting that account will be extended into that column, only the total of which will be posted to the debit side of that account at the end of the week or month. This makes unnecessary a large number of detailed postings during the period. Thus, the cash disbursements side of the cash book shown on pages 42-43 contains special columns for Delivery Expense and Salaries, the totals of which are debited to the Delivery Expense account and the Salaries account at time of summarizing the cash book. Likewise, if special columns are carried in the cash receipts journal for accounts in two or more banks, corresponding columns must be included in the disbursements side in order to show the amounts disbursed from each account. Special columns usually found in cash disbursements book are: General Expense, Payroll, Selling Expense, Notes Payable, Purchase Discount, and Accounts Payable.

Proving and Summarizing Special-Column Cash Book.—When using additional special columns in the cash book, care must be always exercised to maintain the mathematical proof of the accuracy of the entries, this proof being shown at the time the summary entry is made. Thus, in the illustration on pages 42-43, the totals of the Net Cash and Sales Discount columns must equal the totals of the General and Cash Sales columns. Likewise, on the disbursements side, the totals of the General Delivery Expense and Salaries columns must aggregate the totals of the Net Cash and Purchase Discount columns. The method of making the summary entries for each side of the multi-column cash book and balancing the book are also shown.

OPENING OF A BANK ACCOUNT

Steps Taken in Opening Bank Account—Filing of Signature Card—Opening of Bank Account by a Corporation

Introduction to Bank.—In dealing with a commercial bank, the first step is for the prospective depositor to introduce himself to the manager of the bank or be introduced by one of the bank's depositors or some one else known to the bank. If the introduction is satisfactory and the banker desires the party to become a depositor, the arrangement is made to accept whatever moneys the depositor places with the bank, subject to withdrawal by check at all times. A considerable expense is incurred by the bank in safe-keeping its depositors' funds, in handling their checks, and in rendering other miscellaneous services; and more and more banks are beginning to have a service charge for the work performed by them.

Name *Harry F. Greene*

Address *28 State Street*

Business *Druggist* Tel: *2-6128*

Signature and by Whom made:

Harry F. Greene

Introduced by *George Jones*

Approved by *H. R. Brown*

Date *Aug. 15, 19-*

THE OVERTON TRUST COMPANY
OVERTON, NEW YORK

THE OVERTON TRUST COMPANY
OVERTON, NEW YORK

Aug. 15, 19-

Name of Attorney *Robert F. Gray*

is authorized to sign and indorse checks, drafts, and notes, and to accept drafts as attorney for

Official Signature of Depositor here *Harry F. Greene*

and *he* will sign

Harry F. Greene - Asst. Treas.

By *Robert F. Gray*

DO NOT WRITE BELOW THIS LINE

Greene, Harry F., Asst. Treas.

Bank Depositor's Signature Cards

Depositor's Signature.—Before the bank will allow a depositor to draw checks, it must have one or several of the signatures which the depositor intends to use on his checks. Since the bank agrees not to pay out money except on the order of the depositor, it must pass on the genuineness of the signature of every check. This copy of the depositor's authorized signature is made on the signature card, forms of which are shown opposite. The second form is used when the depositor authorizes another to sign his name to checks. Provision should also be made for the signing of checks when those regularly authorized to do so are away. The signature cards are made in duplicate and then placed in files for ready reference by the employees of the bank whenever checks are presented for payment. Separate sets of signature cards are required if checks are to be cashed at more than one branch.

Having supplied his official signature, the depositor receives from the bank a pass-book and two kinds of printed forms. One, known as the deposit slip, is used whenever he makes deposits. The other is a book of blank checks, to be used in making payments and withdrawing cash. The new bank customer thereupon makes his initial deposit.

Bank Account of a Corporation.—The opening of a bank account by an incorporated business must be authorized by a resolution of the board of directors. Such resolution specifies the officers whose signatures are required on each check or on each indorsement of a note or other negotiable paper which may be handled through the bank.

THE BANK PASS-BOOK

Procedure in Making Bank Deposit—Duplicate Deposit Slip

Use of Pass-Book.—When the deposit and the deposit slip have been prepared, they are taken to the bank's receiving teller, who verifies the deposit item by item against the deposit slip and also the total amount. If found correct, the amount is entered in the depositor's bank pass-book which should be presented by him each time a deposit is made, and the teller's initials are placed against it. In the absence of the pass-book, a duplicate deposit slip may be presented for the receiving teller's signature. The pass-book is a small, bound memorandum book with date column at the left, and a wider explanation column, and a single money column.

Dr. THE ALDEN TRUST CO.				in account with *John Jones*			
19__ Aug. 15	*JST*	*427*	*48*				
17	*JST*	*25*					
20	*JST*	*482*	*23*				
25	*JST*	*51*	*20*				
Sept. 2	*JST*	*576*	*82*				
11	*JST*	*582*	*20*				

Bank Pass-book

Entries in the deposit book are always made by the bank teller, who writes his initials or identification mark in the space after date column. This pass-book is a memorandum receipt for moneys turned over to the bank and in most cases it has no other purpose. No entries are made from it in the regular books of account.

Use of Duplicate Deposit Slip.—In many banks the pass-book is no longer used. Instead many firms keep a carbon copy of all deposit slips. When a deposit is made, the duplicate deposit slip is presented along with the original in order that the bank may stamp and initial it as a receipt for the deposit. The original copy is retained by the bank, and is the record from which the depositor's account is credited.

PREPARING CASH FOR DEPOSIT AND THE BANK DEPOSIT SLIP

Preparation of Cash and Deposit Slip—When Cash Receipts Items Are Numerous—Bank Acting as Collection Agent

Sorting and Wrapping the Cash.—The bank deposit slip shown herewith is used for the purpose of listing various kinds of money about to be deposited. Provision is made on the slip for listing separately bills, coins, and checks. All currency should be carefully counted, sorted according to denomination, and wrapped in standard rolls, consisting of 50 cents in pennies, $2 in nickels, $5 in dimes, $10 in quarters, and $10 in half-dollars. Each wrapper should bear the initials of the person who wrapped and checked the count as well as the name of the firm. The bills should be arranged in packages according to their denominations—$1 bills in one package, $5 bills in another, etc.—and in the same order, that is, face up, and all lying one way. Each check in the deposit should be properly indorsed, and its amount should be entered on the deposit slip separately, indicating the name of the drawer of the check, or the account credited with the payment, as this information may prove useful at some future date. If the deposit is large, the list of checks may be made on the adding machine or on a deposit slip provided by the bank, which can be inserted in the adding machine. Checks should be stacked in the order in which they appear on the list. If the pass-book is not presented with the deposit, a duplicate deposit slip must be made out which will be signed by the receiving teller.

Preparing the Bank Deposit Slip.—In preparing the deposit slip all dollar signs should be omitted and the figures should be carefully placed underneath one another so as to make addition easy. Frequently the ordinary bank deposit slip will contain a notation to the effect that the bank merely

DEPOSITED IN

The Continental Bank & Trust Company of New York

BY ________________

December 1 19 --

In receiving items for deposit or collection, this Trust Company acts only as depositor's collecting agent and assumes no responsibility beyond the exercise of due care. All items are credited subject to final payment in cash or solvent credits. This Trust Company will not be liable for default or negligence of its duly selected correspondents nor for losses in transit, and each correspondent so selected shall not be liable except for its own negligence. This Trust Company or its correspondents may send items, directly or indirectly, to any bank including the payor, and accept its draft or credit as conditional payment in lieu of cash; it may charge back any item at any time before final payment, whether returned or not, also any item drawn on this Trust Company not good at close of business on day deposited.

	DOLLARS	CENTS
SPECIE	1	35
BILLS	4	00
CHECKS	10	00
	20	00
	25	00
	40	00
	100	35

Bank Deposit Slip

acts as the depositor's collection agent and assumes no responsibility for loss in the mails or through failure of any other collecting agent. The bank in the same notation may reserve the right to charge back to the depositor's account any amounts it has credited until it has collected the checks and is in possession of the actual funds.

When Cash Items are Numerous.—Where the cash items received are numerous a special form of deposit slip for entry of all these items is used. It may be attached to the cash slip on which all items are first entered, upon the opening of the mail, as shown in the form on page 4. The deposit slip is then prepared simultaneously with the cash slip and its total will correspond with that of the cash slip from which the various accounts will be credited. Entry in the cash receipts book will be made from the bank deposit slip. If there are two or more bank accounts in which deposits are made, a separate deposit slip may be made for each, and there will be a separate column for each bank in the cash receipts book. The daily receipts may, however, be deposited only in one bank and a single deposit slip made out.

Where the daily cash receipts consist of hundreds of small items, they are run off in duplicate on an adding machine tape, which serves as the bank deposit slip. One copy is forwarded to the bank with the cash items, and the other is retained by the firm for its records. If the firm has two or more bank accounts, the adding machine tape is stamped or marked with the name of the bank in which the cash items listed on it are to be deposited. Before running the items off on the adding machine tape, they may be classified according to the type of sale they represent, as cash sales, sales on account, instalment sales, etc. The invoice numbers of the items may also be run off on the tape against the amounts of the items. The invoice number is noted on the back of each check by the bookkeeper when entering the amount on the books. The purpose of having the invoice numbers appear on the adding machine tape is to facilitate making any adjustments in the accounts which later may be necessary.

OPERATION OF THE BANK ACCOUNT

Deposit of All Cash Receipts—Disbursement Exclusively by Check—Operation of Several Bank Accounts

Daily Deposit of Cash Receipts.—The best practice requires that cash receipts of each day should be deposited intact, just as received, in the bank toward the close of the same day. No portion of the receipts should be appropriated for petty cash or other purposes before their deposit. Likewise, all disbursements of funds (with a few exceptions) should be made by check. Strict observance of these two rules is one of the most effective means of protecting the general cash fund against mistakes and embezzlement. It secures a double record—the bank's record and the cashier's record. Any discrepancy is detected whenever comparison of the two records is made. As banks do not usually stay open late enough for the deposit of all the cash receipts of the day, any receipts subsequent to the bank's closing are held over and deposited the next day. Some banks, however, have night depositaries open to receive late deposits.

Accounts with Two or More Banks.—Where regular accounts are maintained with two or more banks, the question must be considered whether to deposit cash receipts more or less in proportion to the size of the accounts carried in each, or whether to make the bulk of the deposits in one bank and make transfers therefrom to the others. Generally speaking, the former policy is more desirable since it distributes the work and expense of collecting the checks equitably among all the banks. The steady use of one bank to make the bulk of the collections throws an undue burden upon it, unless there is a special arrangement with the bank, which is compensated by carrying with it a proportionately larger account, or in other ways. It is not necessary that every day's deposits be split among the several banks, but it may suffice if the deposits of one or two days are made in one bank, the next day or two in another bank, etc.

Similarly, the disbursements should also be fairly distributed among the banks. A small account which is being rapidly turned over by frequent deposits and frequent drawings may not be a very profitable one from the standpoint of the bank.

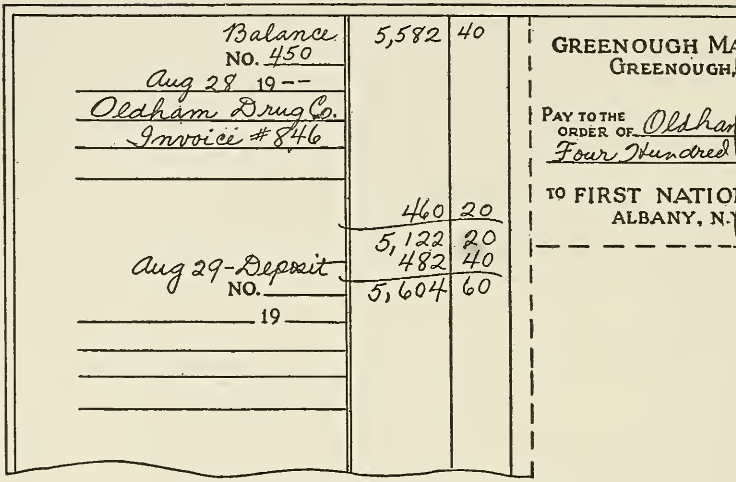
At the end of the month or any other period used, when the bank renders its statement of the account, the canceled checks which the depositing company has drawn are returned to it as evidence of the charges which the bank has made against the account. After the reconciliation of the bank statement with the cash account on the depositor's books, the canceled checks are filed away numerically for possible future reference. These checks may be later needed for purposes of evidence should any question arise regarding past payments.

RECORDING DEPOSITS AND CHECKS ON CHECK-BOOK STUB

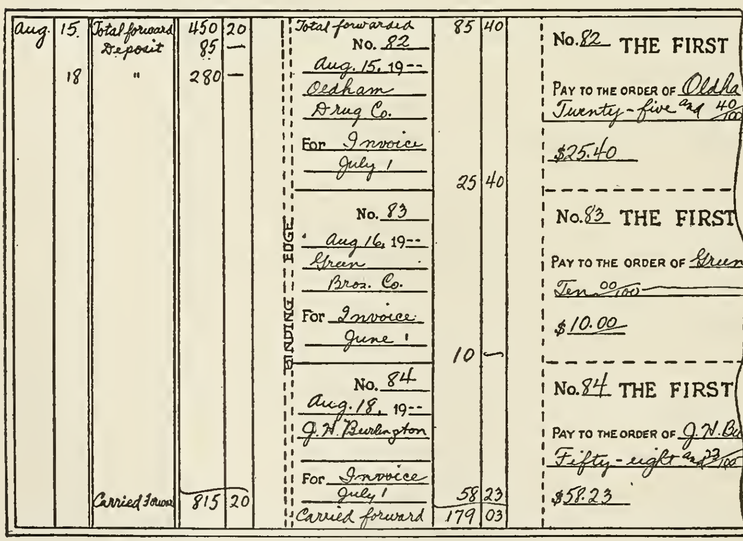
Different Forms of Check-Book Stubs—Making Entry in the Cash Journal

The customary method of making the first record of a bank deposit is to enter its total amount in the stub of the check-book. Each day's deposit is added to the previous balance and the checks drawn that day are subtracted to give the balance which is subject to and payable by check at the moment. In one form of check stub, on page 54, there is a single column for both checks and deposits. In another form, on page 54, there are two distinct columnar sections—one for deposits and the other for checks. Except in very small organizations the check-book stub is merely a memorandum record, not being a part of the regular double-entry system. It serves the purpose of preventing overdrafts, that is, of issuing checks for an amount greater than the funds on deposit with the bank.

All deposits and disbursements made by check are, of course, entered in the cash book. Some bookkeepers make the entries from the stubs of the check-book to the cash receipts and cash disbursements journal.


Balance 5,582 40
NO. 450
Aug 28 19--
Oldham Drug Co.
Invoice #846
460 20
5,122 20
Aug 29-Deposit 482 40
NO. 5,604 60
19
GREENOUGH MA
GREENOUGH,
PAY TO THE ORDER OF Oldham
Four Hundred
TO FIRST NATION
ALBANY, N.Y.

Check-Book Stub with One Column


Aug. 15. Total forward 450 20
Deposit 85 —
18 " 280 —
Carried forward 815 20
Total forwarded 85 40
No. 82
Aug. 15. 19--
Oldham
Drug Co.
For Invoice
July 1
25 40
No. 83
Aug 16, 19--
Green
Bros. Co.
For Invoice
June 1
10 —
No. 84
Aug. 18, 19--
J. H. Burlington
For Invoice
July 1
58 23
Carried forward 179 03
BINDING EDGE
No. 82 THE FIRST
PAY TO THE ORDER OF Oldha
Twenty-five and 40/100
$25.40
No. 83 THE FIRST
PAY TO THE ORDER OF Green
Ten 00/100
$10.00
No. 84 THE FIRST
PAY TO THE ORDER OF J. H. Bu
Fifty-eight and 23/100
$58.23

Check-Book Stub with Two Columns

SPOILED CHECKS

Proper Procedure in Writing Checks—Different Disposition Made of Spoiled Checks—Entry in Disbursements Journal

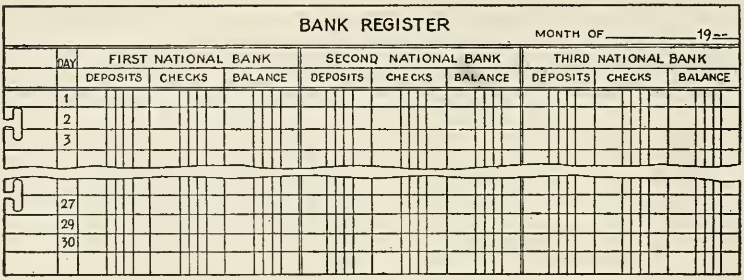
With proper care in writing checks, few, if any, should be spoiled, and to reduce the number to a minimum the stub should in each case be filled out first. When checks are spoiled, however, several methods of handling are used, but any one of the methods described below will usually be satisfactory. The simplest method is to correct the stub record, destroy the spoiled check, and use in its stead a new check detached from the back of the check-book or secured from the bank which keeps loose blank checks (known as "counter" checks) for this and other purposes.

Some concerns, however, insist that no papers be destroyed. Here, the spoiled check is attached to its stub and marked "Void" or "Not Good' across the face, and the signature, if made, is torn off and destroyed, and another check of different number is made out. If it is desirable for the cash disbursements journal to show in numerical sequence all checks, the spoiled check should be entered and complete explanation (including reference to the new check issued in its stead) given, but no amount should be extended in the money column. A line is drawn through the money column to prevent an entry therein.

BANK REGISTER

As a Daily Summary of Cash Book—Its Use by Treasurer in Controlling Financial Activities

The bank register, shown herewith, is a convenient daily summary of the cash book, a line being provided for each day of the month. For each bank with which an account is carried, there is a column for the day's deposits, another for the amount of checks drawn on it, and a third to show the balance—the entries being made from the cash receipts and disbursements journals. The bank register is designed to serve the treasurer in controlling the company's financial activities. Summary columns may also be given to show the total daily



BANK REGISTER MONTH OF ________ 19--

	DAY	FIRST NATIONAL BANK			SECOND NATIONAL BANK			THIRD NATIONAL BANK		
		DEPOSITS	CHECKS	BALANCE	DEPOSITS	CHECKS	BALANCE	DEPOSITS	CHECKS	BALANCE
	1									
	2									
	3									
	27									
	29									
	30									

Form of Bank Register

deposits and checks drawn and the balance. The bank register corresponds to the daily cash statement and is valuable where all disbursements except petty cash are made by check, and all receipts are deposited immediately.

BANK'S STATEMENT OF ACCOUNT

Two Methods Used by Banks in Rendering Statements—Bank's Loose-Leaf Record of Deposit Accounts

To reconcile the record of its Cash account with that of the bank the depositing company receives a periodic statement, usually monthly, from the bank showing its record of the account.

Balancing of Pass-Book.—Two methods are used by the banks in rendering the periodic statement. By the first method, which, however, has now been largely abandoned, the entries in the pass-book representing the deposits made in the bank are totaled and from the total the amount of the canceled and returned checks are subtracted on the page of

THE NATIONAL BANK OF NEW YORK
NEW YORK, N. Y.

ACCOUNT OF

THE BLANK MANUFACTURING CO.
12 EAST 16TH ST.,
2 NEW YORK, N. Y.

STATEMENT KEY
EC—ERROR CORRECTED
CC—CERTIFIED CHECK
M—MAIL DEPOSIT
IN—INTEREST CREDIT
RT—RETURNED ITEM
CM—CHG. OR CREDIT MEMO
LST—TOTAL CHECKS
TX—FEDERAL TAX ON CHECKS, ETC.

DATE	CHECKS—READ ACROSS	DATE	DEPOSITS	DATE	BALANCE
	BALANCE BROUGHT FORWARD ☞			DEC-1-19--	35,466.79
-1	3.00			-1	35,463.79
-3	CM 2.50	-3	2,857.72	-3	38,319.01
-4	1.60			-4	38,317.41
-5	3.00			-5	38,314.41
-7	TX 2.26				
-7	TX .62			-7	38,311.53
-7	110.00			-7	38,201.53
-8	495.00 6.40			-8	37,700.13
		28	CM .22	28	48,788.20
29	CM 3.30	29	CM .15	29	48,785.05
31	1.00			31	48,784.05
		31	5,361.08	31	54,145.13
					LAST AMOUNT ABOVE IS YOUR FINAL BALANCE

THIS STATEMENT OF YOUR ACCOUNT WILL BE CONSIDERED CORRECT UNLESS NOTIFICATION TO THE CONTRARY IS RECEIVED WITHIN TEN DAYS FROM THE DATE HEREOF. PLEASE ADVISE US PROMPTLY AND GIVE FULL DETAILS OF EACH EXCEPTION TAKEN.
ALL ITEMS ARE ACCEPTED FOR ENTRY ONLY, SUBJECT TO FINAL PAYMENT IN A MANNER SATISFACTORY TO US.
ALL ITEMS, NOT PAYABLE AT THE OFFICE OF THIS BANK WHERE DEPOSITED, AND RELATIVE DOCUMENTS, ARE RECEIVED ONLY FOR TRANSMISSION BY MAIL OR OTHER MEANS AT THE RISK OF THE DEPOSITOR AND, WITHOUT LIABILITY TO US, MAY BE ROUTED DIRECTLY OR CIRCUITOUSLY THROUGH ANY OF OUR OFFICES OR CORRESPONDENTS SUBJECT TO THEIR REGULATIONS, OR BE SENT DIRECTLY TO THE DRAWEE OR MAKER OR PAYING AGENT, FOR PAYMENT IN ANY CASE IN CASH, CREDIT TO THE TRANSMITTING BANK, OR DRAFT OR CERTIFICATION OF THE DRAWEE, MAKER, PAYING OR OTHER BANK, ALL WITHOUT RESPONSIBILITY ON OUR PART FOR ANY ACT, NEGLECT OR DEFAULT OF ANY CORRESPONDENT, AGENT, OR SUB-AGENT.
CREDITED ITEMS MAY BE CHARGED BACK AT ANY TIME UNLESS FULL PAYMENT IN CASH IS RECEIVED AT THE OFFICE OF THIS BANK WHERE THE ACCOUNT IS CARRIED.
THE WORDS "OFFICE" AND "OFFICES" AS USED ABOVE COVER THE HEAD OFFICE AND ALL BRANCHES OF THIS BANK.
THE FEDERAL 2C TAX ON CHECKS, ETC., WHICH WE ARE REQUIRED TO COLLECT FROM YOU ON THE ITEMS SHOWN HEREON, IS NOT SHOWN IN THIS STATEMENT, EXCEPT TO THE EXTENT INDICATED. THE BALANCE OF THE TAX (IF ANY) WILL BE CHARGED TO YOUR ACCOUNT AND SHOWN IN NEXT MONTH'S STATEMENT.

Bank's Statement of Account (boldface figures at left are red in original)

the pass-book to give the new balance. The bank also enters any credits or charges on other accounts, as interests on loans, taxes on checks, collection fees, etc. In short, the pass-book is "balanced." An adding machine list of the checks may accompany the canceled checks when they are returned to the depositor.

Formal Statement of Account.—The second method and the one now generally used is for the bank to render a formal statement of account, no use being made of the pass-book except as a memorandum receipt for the deposits made, it never being totaled or balanced. It is customary for banks, by the use of bookkeeping machines, to keep a loose-leaf record of each deposit account, and the statement mailed the depositor, an example of which is shown above, is a transcript of such account. The statement frequently contains an admonition that unless errors are reported in ten days the account will be considered correct.

RECONCILIATION OF BANK STATEMENT

Why Reconciliation is Necessary—Several Methods Used in Making Reconciliation—The True Bank Balance

Discrepancies Between Depositor's and Bank's Accounts.—When the bank's statement of account or the balance as shown by the pass-book is received, it will seldom agree with the depositor's record, for several reasons. So far as checks drawn are concerned, the depositor's record is more up to date than the bank's record. As soon as a check is written, it is entered on the stub of the check-book. The bank, however, knows nothing of the checks drawn until they are presented for payment. Some checks are sent out of town, and others go through the local mail, not reaching the bank until the following day or several days later. These outstanding checks cause the chief difference between the bank's record of the depositor's account and his own.

Other transactions, however, also cause differences. If the depositor holds a customer's note due in a few days and places it with his banker for collection, the bank will not credit his account with the amount until it has actually been collected. Nor does the depositor ordinarily add it to his deposits until he receives notice that the amount has been collected and placed to his credit. If the bank's statement should include this item and the depositor's record not include it—because he has not yet received the notice from the bank—there will be a difference between the two accounts. Again, it may happen that customers' checks deposited and accepted for credit to the depositor's account cannot be collected by the bank. The amount of the uncollected check is then charged back against the depositor's account. If the bank statement takes account of this uncollectible check, while the depositor has not yet been notified of the failure to collect the item, there will be a discrepancy between the two records.

Sometimes the bank allows interest on moneys deposited, and sometimes collection charges are made on checks and notes placed with the bank for collection. The bank knows both the interest which it will credit and the exchange or collection costs which it will charge to the depositor's account, whereas the depositor does not know these facts until notified by the bank.

The foregoing are the chief items that give rise to a difference between the two accounts.

Making the Reconciliation.—In checking one account against the other, the depositor must take all such items into consideration in order to make a reconciliation of the two accounts. For the purpose of safeguarding cash, it is best that the reconciliation be made by some one who does not draw the checks or make the deposits. The first thing to do is to compare the deposit items shown by the monthly statement with the deposit items on the stub of the check-book. Items in one account which are not in the other will account for the difference to that extent. Next, the canceled checks which the bank has returned should be arranged in numerical sequence and compared with the check-book stubs. Frequently, each stub corresponding with a canceled check is marked with a large red or blue check-mark. Checks which the depositor has drawn but which have not yet been presented to the bank for payment will in this way become apparent. A list of these showing the check numbers and amounts should be made. A reconciliation of the two accounts may now be made.

Three methods of reconciliation are used. Under the first, the balance as shown by the bank is reconciled with the balance as shown by the depositor's record; that is, starting with the bank balance, adjust to arrive at the depositor's balance. Under the second, we start with the depositor's balance and bring it into agreement with the bank's balance. Under the third, the difference between the two accounts is found and a statement of the transactions causing this difference is set up.

Reconciliation Illustrated.—In the illustrations following, the first and third methods are used. If the bank's balance includes a credit to the depositor's account of which he has not yet received notice, the bank's balance will be larger by that amount than the depositor's record. Hence, the amount of such credit items—notes collected, interest credited, etc.—must be subtracted from the bank's balance. If there are any outstanding checks, the bank's balance will be larger by the amount of these checks than that shown by the depositor's record. It is necessary, therefore, to subtract from the bank's balance the amount of the outstanding checks in order to arrive at the balance as shown by the depositor's record. When these adjustments have been made, the two accounts should agree. An illustration will make these points clear.

The company's balance as shown by its bank is $63,120 as of March 31. A comparison of the depositor's record and the bank's record of deposits shows that the bank has credited to the company's account the following items for which the company has not yet received notice: A's note collected $3,750 and interest credited for the month of March $34. A comparison of the canceled checks with those which have been drawn, as shown by the depositor's check-book stubs, shows that the following checks are outstanding: #345, $10.25; #346, $110.50; #350, $67.50. The company's record shows that it has a balance in the bank of $59,157.75. Reconcile the two accounts.

(*One Method*)

Reconciliation Statement of Bank Account

March 31, 19–

Bank balance per monthly statement		$63,120.00
Deduct:		
A's note collected but not yet entered in check-book	$3,750.00	
Interest for March credited by bank but not yet entered in check-book	34.00	3,784.00
		$59,336.00
Deduct: Outstanding Checks		
Ck. #345	$ 10.25	
#346	100.50	
#350	67.50	178.25
		$59,157.75

(*Another Method*)

Reconciliation Statement of Bank Account

March 31, 19–

Bank balance per monthly statement		$63,120.00
Check-book balance		59,157.75
Difference		$ 3,962.25
Difference accounted for as follows:		
Deposits not yet entered on check-book:		
A's note collected by bank	$3,750.00	
Interest on bank balance for March	34.00	$ 3,784.00
Checks not yet canceled by bank:		
#345	$ 10.25	
#346	100.50	
#350	67.50	178.25
Difference accounted for		$ 3,962.25

Finding the True Bank Balance.—Neither the bank's balance nor the depositor's balance will necessarily be the correct one. In the case above, the bank has credited the depositor with a deposit which had not been recorded in the depositor's books. On the other hand, the depositor has a record of checks drawn against his deposit of which the bank has no knowledge. The purpose of the reconciliation statement is not necessarily to show the true balance available for checking, but primarily to check the correctness of both records. Two independent records of the same account—in this case one kept by the bank and the other by the depositor—provide the best possible proof of accuracy. The reconciliation statement serves this purpose. If the depositor desires to know the true balance available for checking, he will take account of the deposits with which the bank credits him but which he has not yet recorded on his own books. His own records will then show the true status of his bank account.

In the example shown above, the true balance available for checking is $62,941.75, made up as follows:

Balance as shown by depositor's record		$59,157.75
Add: Items credited by bank but not yet taken into the depositor's record:		
A's note collected	$3,750.00	
Interest for March	34.00	3,784.00
True balance available for checking		$62,941.75

OVERDRAWING THE BANK ACCOUNT

Bank's Attitude on Overdrafts—Small and Large Overdrafts—Laws on Bank Overdrafts

Nature of Overdraft.—When a depositor draws checks for a larger total amount than he has on deposit in the bank, he has overdrawn his account. If the bank should pay the checks as they are presented, a debit balance or overdraft is created in the account. The overdraft is in reality in the nature of an open-account loan made by the bank to the depositor—one not evidenced by a promissory note. The bank is accordingly under no obligation to pay checks after the balance of the account is exhausted. But if the overdraft is small and the depositor is considered good for the amount, the bank may accept the overdraft in order to spare the depositor inconvenience and embarrassment, though it will immediately advise him of the overdraft and expect him to cancel it with a fresh deposit, possibly charging him interest in the meantime. On the other hand, if the amount of the overdraft is large and the depositor's standing is none too good, the bank will refuse to honor the excess checks and will return them marked "Insufficient Funds" to those presenting them for payment.

Effect of Frequent Overdrafts.—Frequent overdrafts are a source of annoyance to a bank and may render the account unsatisfactory to it. In that case it will either insist on no more overdrafts, or failing that, on the withdrawal of the account. Moreover, banks usually expect the depositor to maintain at all times a certain average minimum balance, determined by the amount of service it performs for the depositor as well as the line of credit it extends to him, and unless that minimum is kept, it may make a monthly charge or a charge per item handled, or reimburse itself by increased fees for collection or other services it performs, or by increased interest rates on loans it extends to the depositor. When a firm opens an account and is extended in connection therewith a line of credit, that is, the privilege of borrowing up to an agreed limit, one of the customary terms of such an arrangement is that the firm shall maintain an average deposit balance of no less than 20% of its outstanding loans.

Overdrafts may occur by mistake, but they should never happen knowingly. Many states have laws which make it a crime to draw a check on a bank where there are insufficient funds to pay it. In some states the intent to defraud need not be proved; the mere fact that the check was dishonored by the bank is sufficient to establish legal responsibility.

POST-DATING OF CHECKS

When Post-Dated Checks Are Generally Issued—Bank's Attitude—Entries for Post-Dated Checks

Use of Post-dated Checks.—Post-dated checks are checks which are given a future date. Thus a check drawn on March 2, may be dated March 8. It is, in that event, not payable until the future date, and its recipient must hold it until the date named. Checks are post-dated generally when there are insufficient funds in the bank and it is anticipated that deposits will be made before the day arrives for the payment of the check. Post-dated checks are also issued if they are payable on a certain day out of a particular fund, as dividends for example, and it is found convenient to make out the checks a few days in advance.

While post-dated checks are as valid as checks otherwise drawn, they are not payable until the day of their date. If presented to the bank in advance of their dates, payment will be refused. The use of such checks to meet obligations is contrary to good business practice. They give evidence of financial weakness and injure the maker's credit standing. Moreover, such checks, by inadvertence or design, will not infrequently be presented to the bank for payment, escape the bank's vigilance and cause overdrafts. Banks frown on such practices, and if the practices are persisted in, the bank may be strongly inclined to ask for the withdrawal of the account of such depositor.

Entries for Post-Dated Check.—When a post-dated check has been received in payment of an account, it may be treated as a note receivable and the entry made accordingly, with an appropriate explanation. The check is held until its date, when it is deposited. The entry then will consist of debiting Cash through the cash disbursements journal and crediting Notes Receivable.

STOPPING PAYMENT OF A CHECK

Need of Written Notice to Bank—Bank's Responsibility—Liability of Maker and Indorsers

Sending the Bank Stop-Payment Order.—A depositor has control over the payment of any check he draws, up to the time it is presented at the bank for payment. If he finds that the check was written by mistake, the amount was wrong, or if for any other reason he desires to prevent payment after the check has been issued, he may do so by sending the bank written notice to that effect. He may telephone an order to stop payment, but the bank is legally required to recognize only a written notice. A stop-payment order by telephone should, therefore, be immediately followed by a written notice. Such notice must contain the date of the check, its number, amount, and the name of the payee, in order to enable the bank to identify the check. Blanks on which the required information may be entered are usually supplied by the bank. (See illustration below.) No one but the maker of the check has a right to stop its payment so long as there are sufficient funds in the bank. If the check is not presented to the bank in a reasonable time, the bank may issue a notice of the fact to the drawer and request to be relieved of further liability on the stopped check by the drawer signing and returning the notice to the bank.

Responsibility of the Bank.—Upon receipt of the stop-payment order, the bank is in law responsible to the depositor for omission to comply with his instructions. As the risk to the bank is considerable, it must take every precaution to prevent the accidental payment of the check, and it is, therefore, put to not a little trouble and expense. While the average bank is pleased to cooperate with the depositor in this as well as other matters, it does not take kindly to frequent orders for stop-payment, and the friendly relations between bank and depositor are bound to suffer in consequence.

STOP PAYMENT ORDER

TO INSURE PROMPT AND ACCURATE ATTENTION, PLEASE COMPLETE THIS FORM.

NEW YORK ________________ 19 ___

THE CHASE NATIONAL BANK

________________ BRANCH

NEW YORK CITY.

GENTLEMEN:

PLEASE STOP PAYMENT ON CHECK / DRAFT

NUMBER ________________

DATED ________________

FOR $ ________________

TO THE ORDER OF ________________ ________________

IN WHICH ACTION WE AGREE TO HOLD YOU HARMLESS.

THE ABOVE DESCRIBED CHECK / DRAFT HAS NOT BEEN PAID ACCORDING TO STATEMENT RENDERED TO ________________

SHOULD YOU PAY THIS CHECK / DRAFT THROUGH INADVERTENCY OR OVERSIGHT, IT IS EXPRESSLY UNDERSTOOD THAT YOU WILL IN NO WAY BE HELD RESPONSIBLE.

YOURS VERY TRULY,

____

____

____

AUTHORIZED SIGNATURE

Stop Payment Blank, Supplied by Bank and Filled Out by Depositor

Stopping payment on a check does not relieve the maker or indorsers of liability to an innocent third party who accepts the check in good faith and for value from one who has no right to it.

The printed stop-payment orders, however, which larger banks supply their depositors with, may contain a notation relieving them from any liability for inadvertently paying a check or draft on which a stop-payment order has been issued.

Entry for Stopped Check.—When an order to stop payment of a check has been issued, a reverse entry is made in the cash disbursements journal. The entry is made in the usual way except that a notation of the stopped payment is made in the explanation column and instead of inserting the amount of the check, a cross-reference is made to the previous entry in the amount column. All this may be done in red ink. If by the bank's inadvertence the check should be paid, the reverse entry is canceled.

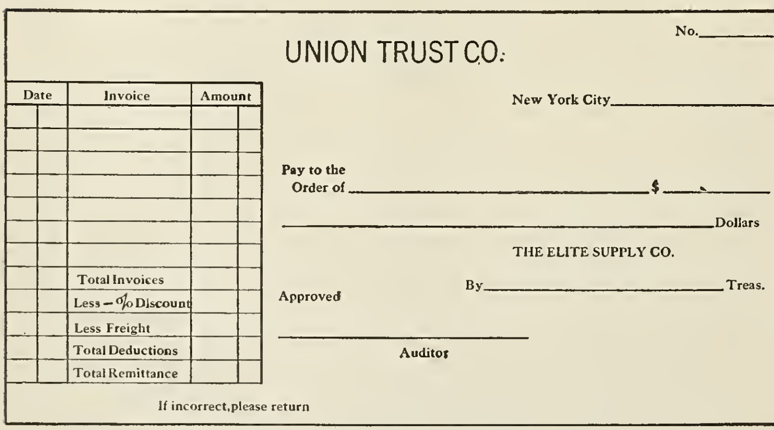
THE VOUCHER CHECK

Advantages in Use of Voucher Check—Forms of Voucher Checks—Procedure in Its Use

Voucher Check as a Receipt of Payment.—The voucher check is one which serves the double purpose of a receipted voucher as well as a means of payment—the ordinary bank check. Under the voucher system of recording purchases, each purchase is settled individually, and it is, therefore, desirable to secure from the vendor a receipt for the payment of a particular invoice. When a separate voucher, or rather the invoice portion of it, is sent for the purpose along with the check, and the vendor is asked to receipt and return it, he not infrequently fails to do this, and if he does, he is put to a certain amount of inconvenience.

To obviate these difficulties the voucher check has been devised. By this method of securing the vendor's receipt, the invoice portion of the voucher is set up in condensed form at one end or on the reverse side of the check remitted to the vendor. When received and deposited by him, it bears his indorsement, and when paid by the bank comes back to the drawer. The canceled check with the vendor's indorsement constitutes at law a good receipt for the payment of the bill, the details or summary of which are stated in the small invoice form on the check. Sometimes the check carries on its face a notation to the effect that the check is issued in payment of the attached invoice. Sometimes also on the reverse of the check, above the space for indorsements, a notation is made that indorsement of the check is acknowledgment of full payment of the bill. When received, the check is clipped to the appertaining voucher along with the other papers involved in the transaction, and the whole then transferred to the paid voucher file.

Forms of Voucher Checks.—Many different forms of voucher check are in use, but in general they are classed into two general groups. The first is what is described as the single voucher check, with the invoice appearing on the face


UNION TRUST CO.

No.________

Date	Invoice	Amount
	Total Invoices	
	Less – % Discount	
	Less Freight	
	Total Deductions	
	Total Remittance	

If incorrect, please return

New York City________

Pay to the Order of ________ $________

________ Dollars

THE ELITE SUPPLY CO.

By________ Treas.

Approved

____

Auditor

(a) Voucher Check—Single

MAKE ALL INDORSEMENTS HERE

Voucher No.________ Check No.________

THE F.E.FOWLER CO.

New York City________________

Pay to the order of ______________________________ $________

____ Dollars

In full settlement of the within accounts

THE F.E.FOWLER CO.

TO CONGRESS BANK AND TRUST CO. By________________________ Treas.

New York City

Voucher No.________ Check No.________

THE F.E.FOWLER CO.

To (Name of Creditor) Dr.

(Address) Terms________

Charge to					(Details of items covered by Voucher)		

Approved

________________________ Auditor

Approved

(Purchasing Dept.)

Passed for payment

________________________ Gen'l Manager

If incorrect, Return; Indorsement is sufficient Receipt

(b) Voucher Check—Folded (*face and reverse*)

Washburn Crosby Company
GOLD MEDAL PRODUCTS
Minneapolis, Minn.

NOTICE THIS IS AN ITEMIZED STATEMENT OF THE ATTACHED CHECK. IF NOT IN ACCORD WITH YOUR RECORDS, RETURN VOUCHER AND CHECK UNALTERED. ANY ALTERATION OR ERASURES RENDER THIS VOUCHER VOID.

VOUCHER NUMBER

DATE OR YOUR INVOICE NO.	PARTICULARS	GROSS AMOUNT	DISCOUNT	NET AMOUNT
01533 10 25 Q		GROSS TOTAL	LESS DISCOUNT	TOTAL OF CHECK

GOLD MEDAL

Washburn Crosby Company
GOLD MEDAL PRODUCTS
Minneapolis, Minn.

VOUCHER NUMBER

CHECK NUMBER

PAY $

TO THE ORDER OF

VOID

PAYABLE AT MAIN OFFICE OF Washburn Crosby Company

BY________________________

DISTRIBUTION OF VOUCHER PAYABLE TO

VOUCHER NUMBER

ACCOUNT		DETAIL	CONTROL
DISCOUNT ALLOWABLE—DR.			
VOUCHERS PAYABLE—CR.			

DATE	
VOUCHER O. K. BY	
ADV. DEPT.	OFFICE MGR.
AUD. DEPT.	PRIV. LEDG.
CLAIM DEPT.	PURCH. DEPT.
FOOD PROD.	P. M. A DEPT.
FRGHT. DEPT.	SALES MGR.
GEN'L BOOKS	SALES RECORD
GRAIN DEPT.	

(first sheet)

(c) Voucher Check with

ATTACH ALL SUPPORTING PAPERS TO THIS COPY

IN PAYMENT OF				
DATE OR INVOICE NO.	PARTICULARS	VOUCHERS PAY.—DR.	DISCOUNT TAKEN	NET AMOUNT
				CHECK TOTAL

SUPPORTING PAPERS REMOVED FROM THIS VOUCHER MUST BE RECORDED IN THE SPACE PROVIDED ON THE REVERSE SIDE OF THIS SHEET

VOUCHER NUMBER

CHECK NUMBER

PAID $

TO

PAID AT

If check is not mailed or is sent elsewhere than to the payee at the address it bears, indicate below:

Given to

Mailed to

at

Check and Vo. Given to

FILE NUMERICALLY BY VOUCHER NUMBER

DISTRIBUTION OF VOUCHER PAYABLE TO

BEFORE FILING, REFER VOUCHER TO

ACCOUNT		DETAIL	CONTROL
DISCOUNT ALLOWABLE—DR.			
VOUCHERS PAYABLE—CR.			

DATE

AUDIT
I certify that this voucher is correct and that the amount is vouched for by invoices or other memos regularly O.K'd by the authorized persons.

DEPARTMENTAL O. K.
I believe this payment to be in order and that the proper routine has been followed as evidenced by the preceding signature.

APPROVED

(second sheet)

Informational Statement Attached

or the reverse side of the check. Such a check with the invoice on its face is shown on page 68. The second form of voucher check, an example of which is illustrated on page 69, is the folded voucher check. With this form more space is available for the invoice portion, on which the details of the vendor's bill are entered. To meet the objections of bankers, who have not liked either of the above forms of voucher checks because of their bulkiness or undue length, a third form has been developed, as illustrated on pages 70-71. The check itself is of regulation size and has attached to it an informational statement, which is detached and retained by the vendor as a permanent record when depositing the check. The voucher number appears both on the check and attached statement. The distribution section is made out when the voucher is written and is then detached and sent to the accounting department for entry in the general and expense ledgers. The second sheet shown in this form of voucher check should be attached to the invoice and other supporting papers and filed as a permanent record of the transaction.

Procedure in Use of Voucher Check.—Where an invoice has been received from a creditor, it must first be verified as to content and extensions. From this invoice, the voucher statement is prepared which shows in as much detail as the form permits the creditor, date and terms of invoice, amount of invoice, cash discount, if any, and net amount of bill. This voucher is then filed in a tickler so that it may be paid promptly within discount period. When date of payment arrives, the voucher is sent to the cashier who prepares the voucher check attached thereto and mails this to the creditor. A duplicate copy or a memorandum thereof is retained in the office so that the bookkeeping department may complete its entries.

When vouchers are paid, and disbursements recorded, the vouchers are filed in numerical order in the paid vouchers file.

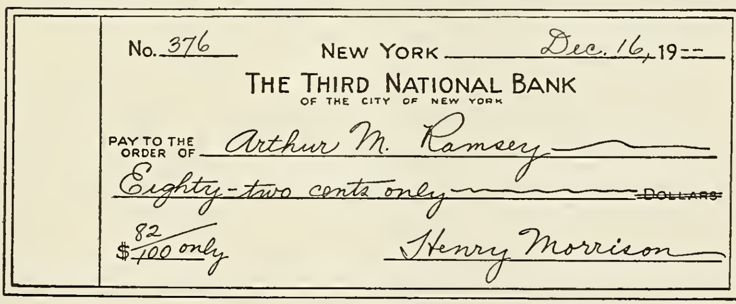
WRITING THE BANK CHECK

Parties to a Check—Standard Forms of Checks—Essential Parts of Check—Forms of Check-Books

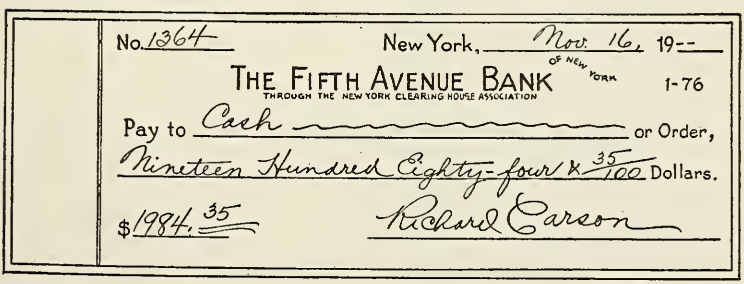
Form of Check.—A check is a written order made by a depositor upon his bank, directing payment of a stated sum of money usually to a named party. The parties to a check are:

1. The drawer or maker, that is, the depositor.
2. The payee, or party to whom the check is made payable.
3. The drawee, that is, the bank on which it is drawn.

By reference to the following illustrations in which two standard forms of check are shown, the essential and non-essential parts of the check may be noted.


No. 376 NEW YORK Dec. 16, 19--
THE THIRD NATIONAL BANK
OF THE CITY OF NEW YORK
PAY TO THE ORDER OF Arthur M. Ramsey
Eighty-two cents only ~~DOLLARS~~
$ 82/100 only Henry Morrison

Check for Less Than One Dollar


No. 1364 New York, Nov. 16, 19--
THE FIFTH AVENUE BANK OF NEW YORK 1-76
THROUGH THE NEW YORK CLEARING HOUSE ASSOCIATION
Pay to Cash or Order,
Nineteen Hundred Eighty-four & 35/100 Dollars.
$ 1984.35 Richard Carson

Check Payable to "Cash"

The *essential parts* are:

1. Date.
2. Name of bank on which drawn.
3. The definite order or demand evidenced by the phrases—
   (a) "Pay to the order of"
   (b) "Pay to bearer"
4. The statement in both words and figures of the sum of money involved.
5. The signature of the maker of the check, that is, the depositor.

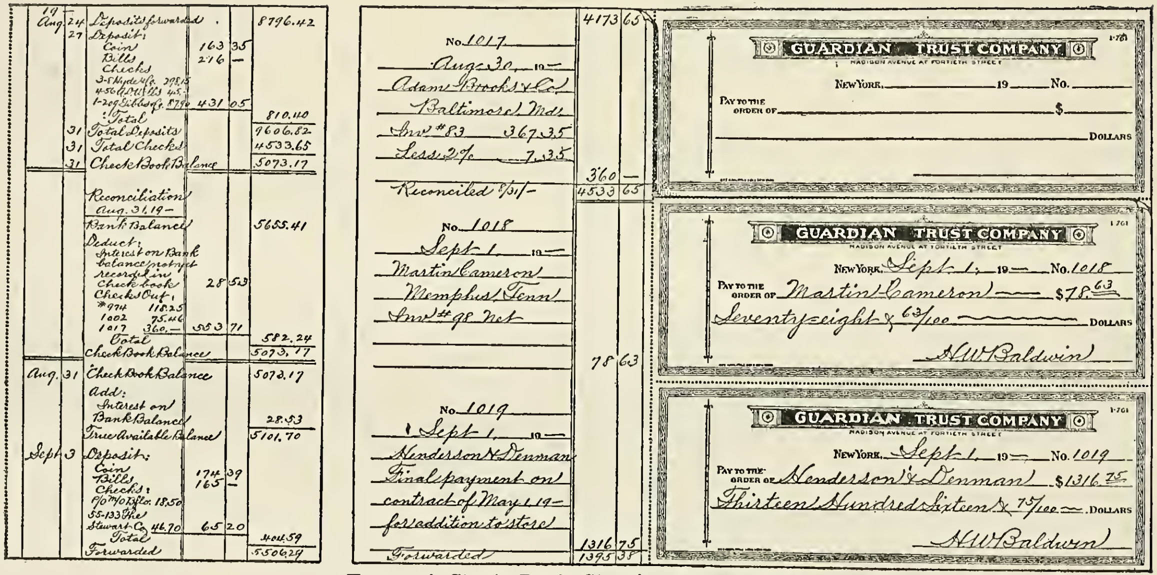
The *non-essential parts* of a check are:

1. The check number.
2. The purpose for which the check is given.

Although not essential, these parts of the check are very convenient, especially the check number which saves time in proving the correctness of the depositor's balance.

Check-Books.—There are many forms of check-books. These are usually provided without charge by the bank in which deposits are made. A small charge, however, may be made by the bank, if, as is usually done in businesses, the firm name is printed on the check. The checks are printed either with several checks or with only one check to the page. Where a stub is not provided, an interleaf between checks is used to record the essential memoranda concerning the check. The form on page 75 shows a check-book with stubs having one side for memoranda of checks drawn and the other for memoranda of deposits made.

Drawing of Check.—In drawing checks it is always best first to fill out stub or interleaf, as this will prevent making errors on the checks themselves, and thus spoiling them. The next steps are to date the check, write the name of the payee; and then write the amount beginning well to the left. No spaces should be left between words, and all blank spaces



19— Aug.	24	Deposits forwarded			8796.42
	27	Deposit: Coin	163	35	
		Bills	276	—	
		Checks 3-5 Hyde & Co. 298.15, 4-56 A.O.W. 45.–, 1-209 Gibbs & Co. 87.90	431	05	
		Total			810.40
	31	Total Deposits			9606.82
	31	Total Checks			4533.65
	31	Check Book Balance			5073.17
		Reconciliation Aug. 31, 19—			
		Bank Balance			5655.41
		Deduct: Interest on Bank balance not yet recorded in check book	28	53	
		Checks Out: #974 118.25, 1002 75.46, 1017 360.–	553	71	
		Total			582.24
		Check Book Balance			5073.17
Aug.	31	Check Book Balance			5073.17
		Add: Interest on Bank Balance			28.53
		True Available Balance			5101.70
Sept.	3	Deposit: Coin	174	39	
		Bills	165	—	
		Checks: 9/0 m/o Taylor 18.50, 55-133 The Stewart Co. 46.70	65	20	
		Total			404.59
		Forwarded			5506.29

	4173	65
No. 1017		
Aug. 30, 19—		
Adams Brooks & Co.		
Baltimore, Md.		
Inv. #83 367.35		
Less 2% 7.35		
	360	—
Reconciled 8/31/–	4533	65
No. 1018		
Sept. 1, 19—		
Martin Cameron		
Memphis, Tenn.		
Inv. #98 Net		
	78	63
No. 1019		
Sept. 1, 19—		
Henderson & Denman		
Final payment on		
contract of May 1, 19–		
for addition to store		
	1316	75
Forwarded	1395	38

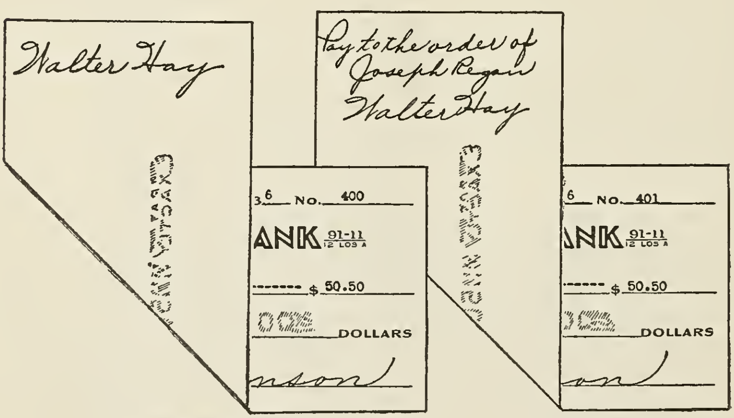
GUARDIAN TRUST COMPANY
MADISON AVENUE AT FORTIETH STREET
1-701
NEW YORK, ______ 19 ___ No. ____
PAY TO THE ORDER OF ______ $ ____
______ DOLLARS

GUARDIAN TRUST COMPANY
MADISON AVENUE AT FORTIETH STREET
1-701
NEW YORK, Sept. 1, 19— No. 1018
PAY TO THE ORDER OF Martin Cameron $78.63
Seventy-eight & 63/100 DOLLARS
H. W. Baldwin

GUARDIAN TRUST COMPANY
MADISON AVENUE AT FORTIETH STREET
1-701
NEW YORK, Sept. 1, 19— No. 1019
PAY TO THE ORDER OF Henderson & Denman $1316.75
Thirteen Hundred Sixteen & 75/100 DOLLARS
H. W. Baldwin

Form of Check Book Showing Reconciliation should be filled with wavy lines. Figures should be written close up to the dollar sign, and it must be made certain that they are legible. Usually a simple plain signature is harder to forge than an illegible one with many flourishes. When writing a check for less than $1 fill in the written amount, "sixty-nine cents only," and cross out the printed word "Dollars." After the amount in figures one may also write the word "only," for example, "$\frac{69}{100}$ only." Banks, however, do not look with favor on drawing of checks for less than one dollar. A check is often made payable to "Cash," "Myself," "Bearer," "New York Draft," "Payroll," etc. This indicates that the check is payable to a bearer. A check made payable to "New York Draft," "Payroll," etc., indicates the purpose for which it is drawn.

Check Indorsements.—For purposes of transfer, before presentation to the bank drawn on for payment, checks must be properly indorsed. The various forms of indorsement explained in connection with promissory notes (page 228) are also used for checks. The full indorsement is preferable in



Blank Indorsement Full Indorsement

all cases. This is shown opposite. Checks made payable to "Cash" when presented to the bank by the maker, do not ordinarily have to be indorsed. Those made payable to "Myself," "Bearer," or "Payroll," if the cash is to be passed over the counter to the maker of the check or to another party, must usually be indorsed by the receiving party. A check made payable to a special payroll account in the bank, to be disbursed by it, and checks so drawn that the bank itself is to get the funds and is to pass them over the counter to the one presenting the check, do not ordinarily require indorsement.

Protective Devices Against Forgery.—Various devices are used to protect against fraud, in issuing checks, as where the amount of the check is cut into or perforated through the paper and the cut edges inked with indelible ink; the use of printed marginal maximum amounts so that the check will not be good for more than the indicated maximum; the use of special watermarked paper, and of forge-proof ink. These have all been helpful but are not wholly successful. The bank is liable if it makes payment on a check with a forged signature. In the case of alteration of other portions of the check, as for example, raising the amount, the maker usually suffers the loss. Writing the check in accordance with directions given above prevents many of the simple and more apparent alterations. However, even the best protected checks are often changed by a clever crook in such a way as to escape detection by the watchful eye of the bank clerk.

THE DRAFT AS A NEGOTIABLE INSTRUMENT

Parties to a Draft—Sight and Time Drafts—Procedure in Accepting Draft—Draft Payable After Date

Draft Defined.—The draft is defined as an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is

$250.00 New York, NOV 26 19– 19–
At sight Pay to
the order of J. Richard Huling
Two Hundred Fifty xx/xx Dollars
Value received and charge the same to account of
To Gordon Jones
No. Buffalo N. Y. Wm Price

(a) Sight Draft

$348 35/100 New York, Nov. 22 19–
Thirty days after sight Pay to
the order of Russell, Ward & Nixon
Three hundred forty-eight 35/100 Dollars
Value received and charge the same to account of
To John D. Williams
No. 27 Winona, Minn. Paul P. Stewart

Accepted Nov. 2[illegible] 19– Payable at [illegible] National Bank [illegible] John D. Williams

(b) Time-After-Sight Draft—Accepted

$94 xx/xx New York, August 15 19–
Sixty days after date Pay to
the order of Gilmore Mitchell
Ninety-four xx/xx Dollars
Value received and charge the same to account of
To Charles W. Hamilton
No. 43 Cadillac, Mich. D. W. Chesterfield

Accepted August [illegible] 19– Charles W. Hamilton

(c) Time-After-Date Draft—Accepted

addressed to pay upon demand or at a fixed or determinable future time a stated sum of money to a third party or to bearer. The party who draws the draft is called the *drawer,* the party on whom the draft is drawn is the *drawee,* and the party to whom the draft is made payable is the *payee.* The bank check is a common form of draft, inasmuch as it is an order by the depositor upon the bank to pay another party. It is not customary to refer to it as a draft, however. In actual practice drafts are frequently made payable to the drawer, so that drawer and payee are the same person. By indorsing the draft as payee the drawer is able to negotiate the draft with any bank or other party.

Kinds of Drafts.—Drafts are classified on several bases:

1. Geographically as to place.
2. As to time of payment.
3. As to the parties.

1. Classified geographically as to place, drafts are:

(a) *Domestic,* or inland drafts, those drawn and payable within the same state.
(b) *Foreign drafts,* those drawn in one state but payable in some other state or a foreign country.

Thus, a draft drawn in New York and payable in Chicago becomes a foreign draft. Similarly, a draft drawn in New Orleans and payable in Brazil is a foreign draft. A draft drawn in San Francisco but payable in Los Angeles is, however, a domestic, or inland bill. A draft drawn on New York is known as a New York draft; on a Chicago bank as a Chicago draft.

2. Classified as to time of payment, drafts are:

(a) *Sight drafts,* which are to be paid as soon as presented to parties on whom they are drawn [see form (a)].

(b) *Time drafts,* to be paid some time after they are first presented and accepted, that is acknowledged by the drawees as their obligations.

Time drafts may be drawn for a certain number of days after sight or after date. When a draft is payable after sight, it matures a certain number of days or months after acceptance [see form (b)]. It is important, therefore, that the party on whom it is drawn be found and the draft presented for acceptance as soon as possible, in order to establish the date of payment. A draft payable a certain time after date, however, has its payment date determined by counting forward from the date on which it was drawn.

3. As to the names of the parties, drafts are sometimes classified as *bank drafts* or *commercial drafts.* If one bank draws on another bank to make payment, the draft is a bank draft, whereas if one merchant draws on another merchant, the draft is a commercial draft.

Acceptance of a Draft.—For a time draft to be binding at law, the drawee must signify his willingness to make payment as requested in the draft. Without such written acceptance, the draft has no more legal status than an ordinary request. This acceptance by the drawee binds him to the contract as stated in the draft and makes him primarily liable.

Acceptance is usually signified by writing across the face of the draft the word "Accepted" and the date, followed by the signature of the drawee. Banks frequently act as agents in securing acceptance of drafts. See forms (b) and (c).

BOOKKEEPING ENTRIES FOR DRAFT TRANSACTIONS

Entries on Books of Drawer, Payee, and Drawee—When Draft Accepted and When Paid—Dishonored Draft

Inasmuch as a merchant may at different times be the drawer, drawee, or payee of a draft, it is necessary to consider the entries to be made under each of these situations. It will be assumed that John Squires draws a sight draft on Rodney MacDougal, made payable to James Rogers & Co.

Entries on the Books of the Drawer.—When drawer and payee are—

Different Parties.—If a sight draft is drawn, the drawer, John Squires, will debit the payee, James Rogers & Co., to show the settlement of his debt to him, and credit the drawee, Rodney MacDougal, to show that MacDougal settles the debt he owes Squires.

The Same Party.—In case the drawer and the payee are the same party—that is, in case Squires draws the draft in favor of himself, the draft reading "Pay to the order of myself," and being used for collection purposes—no entry will ordinarily be made by the drawer until he has received notice that the draft has been collected, when the entry will consist of:

Cash	$499.50	
Collection and Exchange	.50	
Rodney MacDougal (Drawee)		$500.00

When the Draft Is Protested for Non-acceptance.—When the draft is protested for non-acceptance by drawee and returned by the payee to the drawer, the original entry must be reversed, as follows:

Rodney MacDougal (Drawee)	$500.00	
James Rogers & Company (Payee)		$500.00

If Rogers & Company paid the expense of protesting, the drawer will make the following entry:

Expense (of Protest Fees)	$2.50	
James Rogers & Company (or cash)		$2.50

If the drawer reimburses Rogers & Company immediately for the expense of protesting, the credit item in the above entry will be to Cash instead of to James Rogers & Company.

If the draft is for collection and the payee and drawer are the same person, no entry is necessary if the draft is protested, since no entry was made at the time it was drawn. Payment of the draft by the drawee at maturity does not affect the drawer, and so no record is necessary. If, however, an accepted draft is protested for non-payment at maturity, the entries for such a transaction are the same as for the protested promissory note. (See page 225.) In this case the entry would be:

Rodney MacDougal	$502.50	
Cash		$502.50

Entries on the Books of the Payee.—The transaction is now being recorded from the standpoint of James Rogers & Company, the payee.

When the Draft Is Received.—When a sight draft is received by James Rogers & Company, the entry is:

Cash	$500.00	
John Squires (Drawer)		$500.00

Since this is a sight draft, the payee may wait until the draft has been collected, or make the entry as soon as the draft is received.

If the draft is "after date" or "after sight," the following entry is made when the draft is received:

Notes Receivable	$500.00	
John Squires (Drawer)		$500.00

Sometimes this entry is deferred until the draft has been presented to the drawee for acceptance. Theoretically, this latter method is preferable, since drafts prior to acceptance are not promises to pay, that is, notes receivable. Practically, however, the entry as given keeps track of the draft.

When the Draft Is Paid.—When the draft is paid at maturity, the following entry will be made on the books of the payee:

Cash	$500.00	
Notes Receivable		$500.00

If the Draft Is Dishonored.—If the draft is dishonored for non-acceptance or non-payment, the reversing entry, in the case of a sight draft, will be:

John Squires (Drawer)	$500.00	
Cash		$500.00

In the case of a time draft ("after sight" or "after date"), the reversing entry will be:

John Squires (Drawer)	$500.00	
Notes Receivable		$500.00

An additional entry will be made to record the payment of protest fees incident to the dishonored draft:

John Squires (Drawer)	$2.50	
Cash		$2.50

Note that this is charged to Squires, as it is an expense which he, and not James Rogers & Company, should bear.

Entries on the Books of the Drawee.—The following entries are made on the books of the drawee, Rodney MacDougal.

When Draft Is Paid Prior to Acceptance.—If a sight draft is presented or if a time-after-date draft is not presented for acceptance until its date of maturity, the following entry will be made by the drawee if he honors the draft:

John Squires (Drawer)	$500.00	
Cash		$500.00

When Draft Is Accepted.—If the above draft is a time draft and it is presented to the drawee, MacDougal, for acceptance and he accepts it, the following entry will be made on his books:

John Squires (Drawer)	$500.00	
Notes Payable		$500.00

If for any reason MacDougal refuses to accept the draft, he makes no entry on his books, since the original record of the transaction still holds.

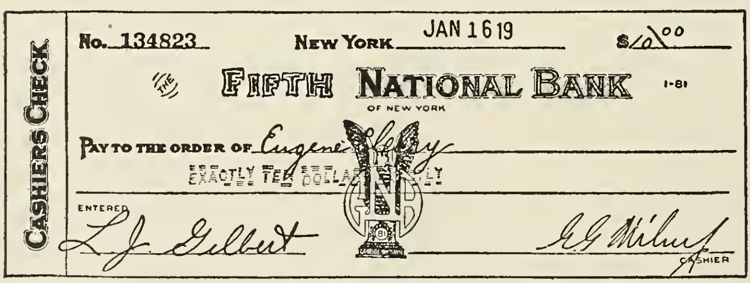
When an Accepted Draft Is Paid.—When MacDougal pays the draft at maturity, he will make the following entry:

Notes Payable	$500.00	
Cash		$500.00

CASHIER'S CHECK

Its Use in Making Payments to Non-depositors—As a Form of Exchange

A cashier's check (see form below) is a check drawn by a bank on itself and signed by its cashier. In effect it is the bank's promise to pay on demand. It is generally used by the bank to make payments to those who are not its deposi-



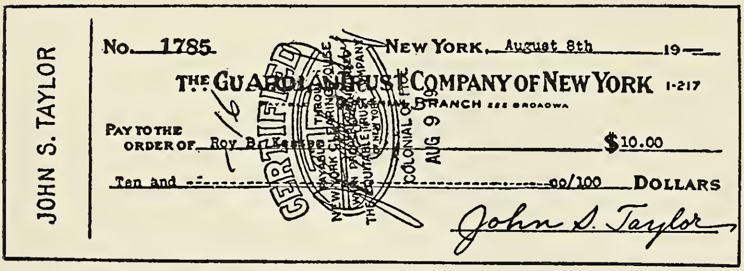
Cashier's Check

tors. Such payments include loans made by the bank to non-depositors. But a common use of this form of the bank's obligation is also in making remittance where an ordinary check on a bank is not acceptable. It is, in other words, a form of exchange. Cashier's checks are purchased by remitters, the bank making a charge for the loan of its credit in this form.

CERTIFIED CHECKS

Certification of Checks—When Certified Checks Are Used—Presentation of Checks for Certification—Bank's Liability

Effect of Certification.—Certified checks are required for some business transactions such as payment of taxes, licenses, etc., and are desirable for many others. A certified check is one on the face of which is the bank's certificate that the check is good. The bank's statement that the check is good carries



Certified Check

greater weight than does the individual's because the bank is a better known institution. Any check may be certified by presenting it to the bank in which the funds drawn on are deposited and having the bank's statement written or stamped across its face that the check is good or that it is accepted. A form of certified check is shown above.

In the case of certification or acceptance of a check by the bank, the bank and not the depositor becomes liable for the payment of the check. To carry this liability into effect, the bank charges the depositor's account as soon as the check is certified and the amount of the check is transferred to the general funds of the bank. When the check is presented for payment, the bank's funds and not the depositor's will be used to meet it.

Presentation of Check for Certification.—Either the payee or the drawer of a check may present it for certification. A payee may desire to have a check certified because he does not care to collect payment from the bank immediately or because he wishes to send the check through the mails to another party. When the payee has a check certified, the maker is absolutely released from all liability for payment.

The drawer may desire to have his check certified before sending it to a creditor in order to make the funds immediately available for the creditor instead of compelling him to wait until the check can be collected by his bank. It is customary to deposit certified checks as evidence of good faith when bidding on a contract. If the drawer of a check has it certified, he is not entirely freed from all liability inasmuch as the courts have held that he is still liable in case the bank fails before the check is presented for payment. Because a certified check has been charged to the drawer's account, it should be deposited in his bank account if unused, not destroyed.

BANK DRAFTS

Purchase of Drafts—Drawn Payable to Purchaser—New York Exchange

Bank drafts are sight drafts drawn by small interior banks on banks in the larger cities, and are used when the ordinary bank check is not an acceptable form of payment. The one making the remittance purchases the draft from the drawer bank, paying the face amount of the draft plus a charge for the service, amounting to a fraction of one per cent. Frequently the draft is made payable to the remitter, who before remitting it places his indorsement upon it. In this manner his name appears on the draft, and the draft, though held in the files of the drawer bank upon being cashed and returned, constitutes better evidence of the payment in case of dispute, since it shows the name of the remitter as payee and original indorser. Most bank drafts are drawn on New York City banks, in which interior banks keep accounts, because they are the most acceptable throughout the country. These drafts are frequently referred to as New York exchange, or New York drafts. If drawn on a Chicago bank, they are called Chicago exchange or drafts.

CERTIFICATE OF DEPOSIT

Use in Lieu of Bank Deposit—Payment of Certificate—Transferability

Certificate of Deposit Defined.—A certificate of deposit is an instrument signed by an officer of the bank, certifying that the named party has deposited money for a stated amount. It is either payable on demand or at a stated period. In the latter case it bears interest. Part payments may be made by the bank upon it and the amounts entered on the back of the certificate or the old certificate taken up and a new one issued.

Demand certificates of deposit are treated by banks as demand deposits, while time certificates, or those payable at a stated period, are treated as time deposits.

When Used.—Such a deposit is not subject to check, and is frequently issued to those who have regular accounts with the bank. If, for example, a depositor of a bank in a small town desired to make a time deposit in a bank in a large city simply for the interest it will draw, without any intention of establishing any permanent relations with the bank, the deposit will take the form of a certificate instead of a regular deposit account. However, the fact that the certificate is transferable, particularly if it is payable on demand, renders it at times a convenient form in which even depositors may carry at least some of their time deposits, or deposits withdrawable upon the expiration of a stated period.

EXPRESS, POSTAL, AND TELEGRAPH MONEY ORDERS

When These Forms of Remittances Are Used—Charges Made for These Remittances

Where there is no bank account or remittance by check is unavailable for other reasons and the amount of remittance is comparatively small, the express money order or the postal money order is frequently resorted to as a means of transferring funds.

Express Money Order.—Such money orders are sight drafts issued by certain large companies which formerly did an express transportation business as well, and which are still referred to as express companies. The drafts, made payable to designated parties, may be purchased at any one of the many offices of these companies distributed all over the country, and they may be cashed at any other office. They may, however, be collected through a bank. Express money orders may be indorsed and transferred any number of times.

Postal Money Order.—The postal money order is issued by the United States Post Office Department, and is used by those without bank accounts, whose remittances are usually for small amounts. In requesting a postal money order, the applicant fills out a form, and presents it at his post-office which thereupon issues to him against payment of the required amount, including a service charge, the money order payable to a stated party at any post office. A receipt is also received for the money paid.

The cost of postal money orders varies from 5 cents for orders of from 1 cent to $2.50, to 22 cents for orders from $80.01 to $100. Business use of postal money orders is largely limited to making payment for C.O.D. items sent by mail. Postal money orders may be transferred but once by indorsement.

Telegraph Money Orders.—These money orders are used in situations requiring the quick transfer of funds. The telegraph, cable, or radio companies will pay to the payee specified in the telegraph money order, upon proper identification. The cost for this service by telegraph is the cost of a 15-word telegram to the payee's destination, plus a service charge based upon the amount of the money order.

CASH DISCOUNT TERMS

Net Selling Price Defined—Relation of Cash Discounts to Trade Discounts—Figuring Cash Discounts—Typical Cash Discount Terms

Credit Period.—Most firms sell goods on certain terms with respect to the time of payment. The sales may be for cash, the remittance to be made upon the receipt of the goods, or payment may be made in advance of shipment, as cash with order. Many business organizations, however, sell goods on account, allowing the purchaser a stipulated period in which to pay for the invoice, which is called the credit period. These credit terms, or merely "terms," as they are commonly referred to, are specified in the invoice and they may range from "Cash" up to six months or longer. The more common terms are 30 days and 60 days. If payment of the invoice is due in, say, 30 days, the expression "Terms; net 30 days" will appear on the invoice. This may take the more abbreviated form "n/30." The word "net" in these expressions refers to the invoice amount, which is the net selling price, that is, the list price less any trade discounts allowed.

Deduction of Cash Discount.—Firms which sell on account frequently offer customers a percentage deduction from this invoice amount if payment is made sooner than the regular terms within a few days from the invoice date, usually ten. This deduction is called cash and sometimes merchandise discount. From the standpoint of the seller it is cash discount on sales, or merely sales discount; from the standpoint of the buyer, it is cash discount on purchases, or merely purchase discount.

When a cash discount is allowed, the rate of discount and the time within which the buyer may make the deduction, is shown in the terms on the invoice. For example, the regular terms of payment are net 30 days, meaning that the invoice amount is payable at the end of that number of days from the invoice date. At the same time a discount of 2% is allowed if payment is made within 10 days from the invoice date. As expressed in the invoice the terms are "2% 10 days, net 30 days," or "2/10, net 30," or "2% 10/n 30." The date of the invoice is usually the date the goods are shipped, and the discount period begins to run from the invoice date, no matter when the buyer receives the goods.

Cash discounts are figured on the invoice amount, or the net selling price. When the invoice is prepared, the trade discounts, if any are allowed, are deducted on its face in order to arrive at the net selling price. Since the cash discount may or may not be taken by a buyer, as he may choose to avail himself of the entire credit period, this discount is not deducted on the invoice. It is deducted by the buyer when he remits payment within the stipulated discount period, of 10 days, in the foregoing example. If the invoice amount is $1,000 and the discount rate is 2%, he will remit $980 in payment of the bill. If, on the other hand, the buyer fails to remit even within the regular credit period of, say, 30 days, he may be charged interest for the time over the credit period. The date on which check is mailed is usually regarded as the effective date of payment. This is important in case of dispute as to whether the discount should be allowed.

Typical Terms.—Various kinds of cash discount terms are offered buyers, but a particular business will usually adopt a particular set of terms to which it will adhere as a matter of policy in its sales to all customers or certain classes of customers. Moreover, within a particular industry, due to competition, the terms tend to become standardized, and all doing business within that industry will offer about the same terms.

The following are typical terms of cash discount, an explanation being set opposite each.

1% 10 d.	1% discount if paid within 10 days.
Net 30 d.	Pay net within 30 days.
2% 10th proximo	2% discount if paid by the 10th of the following month.
5% e.o.m.	5% discount if paid by the end of the month.
2% 10/n 60	2% if paid in 10 days or net if paid from 11 to 60 days.

If a seller quotes a price f.o.b. destination, meaning delivery at his expense at the buyer's place of business, the invoice price includes the cost of freight. In this case the cash discount should be figured on the basis of the invoice amount less the freight.

RECORDING CASH DISCOUNTS ON PURCHASES

Entry as Made in Various Types of Journals—Purchase Discounts in the Profit and Loss Statement—"Discounts Lost" Account

When Entry Is Made in General Journal.—A bill of goods is purchased from J. H. Smith & Company for the invoice amount of $1,000, on terms 2/10, n/30, which call for remitting $1,000 if payment is made 30 days from the invoice date, but only $980, or the invoice amount less a deduction of 2%, if remittance is made in 10 days from the invoice date.

If the discount is taken and $980 remitted in full settlement, the entry on the books, if the general journal is used, will be:

Merchandise Purchases	$1,000.00	
Cash		$980.00
Purchase Discount		20.00
Payment of invoice, No. 7, within cash discount terms of 2/10, n/30.		

When Entry Is Made in Cash Disbursements Journal.— When a cash disbursements journal is used, the entry may be made partly in this special journal and partly in the general journal, as follows:

Cash Disbursements Journal

Date		Accounts, Dr.	Explanation	F	Items	Total
19— April	7	J. H. Smith & Co.	Purchase of 3/28 less 2%—see G.J. p–		980 –	

General Journal

		April 7, 19– J. H. Smith & Co. Purchase Discount Allowance of 2% cash discount on Invoice No. 7 See C. D. J. p.–		20 –	20 –

When the ledger is posted from these two journals, J. H. Smith & Co.'s account, which contains a credit of $1,000, will be debited with two items, $980 from the cash disbursements journal and $20 from the general journal, while Cash will be credited $980 from the cash disbursements journal and Purchase Discount with $20 from the general journal.

The entire entry for the cash remittance of $980 may be made in the cash disbursements journal alone, if a form is used providing a column for purchase discounts. Thus:

CASH DISBURSEMENTS JOURNAL

Date		Accounts, Dr.	Explanation	F	Debit Amount	Credit Purchase Disc.	Credit Net Cash
19— Apr.	7	J. H. Smith & Co.	Purchase of 3/28 less 2%		1,000 -	20 -	980 -

The posting to J. H. Smith & Co.'s account may also be made by entering $980 on the main line of the ledger and $20 just above in smaller figures, so as to show that the discount was taken on the purchase. When thus posted the account will appear, as follows:

J. H. SMITH & CO.

19— April	7		20 - 980 -	19— March	28	2/10	1,000 -

Purchase Discounts Account.—Various titles are used for the account recording purchase discounts, such as Purchase Discounts, Discounts on Purchases, Discounts Earned, and Discounts Received.

Purchase discounts represent income, and at the end of the fiscal period the account containing them must be closed into the Profit and Loss account. In the profit and loss statement, the total of purchase discounts will appear in the group of items constituting financial management income, including such items as interest or rent received.

When discounts allowed on purchases are large and are invariably taken, it is proper to deduct them from the invoice price and make a charge to purchases only for the net amount. If under such procedure a case should arise when the discount is not taken, the discount should be charged to a "Discounts

Lost" account, and no charge need be made in the handling of purchases on the books.

RECORDING CASH DISCOUNTS ON SALES

Several Methods of Recording—Posting the Journal Entry—Discounts on Sales to Employees—Sales Discounts in the Profit and Loss Statement

Journal Entry.—A bill of goods for $1,000 is sold to Thomas Cameron on 30 days' credit with the option of settling within 10 days with an allowance of 2% from the invoice amount as a cash discount. In other words, the sale is on a cash discount basis and the terms, as usually stated, are 2% 10 days, net 30 days, or 2/10, n/30. When the goods are shipped and the invoice is forwarded, Cameron's account is charged through the general journal or the sales journal with the invoice amount of $1,000, while Merchandise Sales is credited with the amount.

If Cameron pays $1,000 at the end of 30 days from the invoice date, his account is credited, while Cash is debited, with $1,000. If, however, he makes settlement within 10 days of the invoice date, he deducts 2% or $20 from the invoice amount, and therefore remits only $980 in full settlement of the account.

Recorded in the general journal only, the settlement appears as follows:

Cash	$980.00	
Sales Discount	20.00	
Thomas Cameron		$1,000.00
Payment of invoice No. 25, with cash discount terms of 2/10, n/30.		

Where in addition to the general journal a cash receipts journal is used, the settlement may be entered in both journals as follows:

Cash Receipts Journal

Date		Accounts, Cr.	Explanation	F	Items	Total
19— April	7	Thomas Cameron	Sale of 3/28–, less 2% See J.p.–		980 –	

General Journal

		April 7, 19–			
		Sales Discounts		20 –	
		Thomas Cameron			20 –
		Allowance of 2% cash disct. on $1,000 sale of 3/28/–. See C. R. J. p.–.			

A third method for recording the cash received is in a cash receipts journal with a special column for sales discounts taken by customers which dispenses with the use of the general journal entirely. Thus:

Cash Receipts Journal

Date		Accounts, Cr.	Explanation	F	Credit Amt.	Debit Sales Disc.	Debit Net Cash
19— Apr.	7	Thomas Cameron	Sale of 3/28 less 2%			20 –	980 –

Whichever form of entry is used to record the sales discount, when settlement is made within the cash discount period, the customer is credited for the total invoice amount, $1,000, in the case of Thomas Cameron, while Cash is debited for amount actually received, or $980, and Sales Discount is debited with the amount of the discount, or $20.

Posting to Customer's Account.—In posting the credit to the customer's account, it is best to post the $1,000 in two amounts, $980 on the main line and $20 just above in smaller figures. Bookkeepers frequently do this in order to show in the account that the customer has deducted his discount. Had only one amount, $1,000, been entered, an inspection of the account would not show whether the customer paid his bill in time to take the discount or waited until the full credit term had expired. When completely posted, the account will appear as follows:

THOMAS CAMERON

19— March	28			1,000	-	19— April	7			20 980	-

Under another method, the $1,000 credit is posted as one item in the customer's account and the $20 discount is entered as a memorandum in the explanation column, as follows:

THOMAS CAMERON

19— March	28			1,000	-	19— April	7	2%, $20		1,000	-

Closing of Account.—Any one of several titles can be used for the sales discount account—Discount on Sales, Sales Discount, Discounts Allowed, Discounts Lost, Merchandise Discounts, etc.

The Sales Discount account is an expense account, and at the close of the fiscal period is closed into Profit and Loss account. In showing the item in the formal statement of profit and loss, it is included under the Financial Management Expenses, or similar heading. This group consists of all expenses incurred in borrowing or obtaining money, such as sales discount and interest cost. If the sales discount per cent is very large or the time allowed very long, the discount is treated as a trade discount. In that event the total sales discount is deducted from Gross Sales amount on the profit and loss statement.

Sales Discounts Allowed Employees.—Some concerns allow their employees sales discounts, enabling them to purchase goods practically at cost price. Such discounts, instead of being charged to the regular Sales Discount account, may be debited to a separate account bearing some such descriptive title as "Discounts on Sales to Employees." Another method is not to record the discount at all but simply to credit the Sales account with the net price received.

HANDLING CASH DISCOUNTS ON PURCHASES UNDER VOUCHER SYSTEM

Recording Cash Discounts in the Check Register—Making Entry Instead in Voucher Register—Adjustments That May Be Necessary

Monthly Summary Entries.—When the voucher register is used in place of the ordinary purchase journal, no individual ledger accounts are kept with creditors. The credit and debit entries are merely made to one summary general ledger account, Vouchers Payable, or Accounts Payable, by monthly totals. The cash discounts on purchases which are a part of the credit entries made in recording the payment of bills, are similarly handled by monthly totals for all the creditors instead of individually for each creditor.

Recording Cash Discounts on Cash Disbursements Journal.—Practice varies somewhat, however, in this general method of handling purchase discounts in connection with the voucher register. Probably the most usual method is to make the voucher, which is the office representative of the creditor's invoice, for the gross or invoice amount, enter this amount as a credit in the Vouchers Payable column of the voucher register, and divide the offsetting debit entry in appropriate columns in the so-called distributive section of the register, containing columns to record newly acquired assets and expenses. (For an illustration of a voucher register, see page 153.) No cash discount column is provided in the register any more than one is used in the regular purchase journal; or if one is employed, it is merely a memorandum column, which is ignored in making postings. When a bill is to be paid in time to secure the discount, the amount of the discount is deducted on the voucher in order to arrive at the net amount for which the check is to be drawn. The payment will be entered in the check register by inserting the gross or invoice amount in the Vouchers Payable column, the amount of the cash discount in the cash discount column provided for the purpose, and the amount actually paid in the Net Cash column. At the end of the month when the totals of the columns of the cash disbursements journal are posted to the general ledger, the total of the cash discount column will be credited to the Cash Discount account, and debited to Vouchers Payable instead of to individual creditors' accounts.

Recording Cash Discounts on Voucher Register.—Where concerns can count on being able to take all cash discounts on purchases promptly, they sometimes make up their vouchers for the net amount of the purchase, that is, for the invoice amount less the discount. This net amount is entered in the Vouchers Payable column of the voucher register, and the amount of discount they anticipate taking in the Cash Discount column, which under this system of recording is provided in the voucher register instead of the check register. After the lapse of the stipulated discount period, a check for the net amount of the voucher is mailed the creditor, and the amount is entered in the Vouchers Payable column and Net Cash column of the cash disbursements journal. It is also customary to provide a cash discount column in the cash disbursements journal for entry of the cash discounts, but this is only for memorandum purposes. At the end of the month when the totals of the columns in the voucher register are posted, the total of the cash discounts column is credited to the Cash Discounts account. The offsetting debit was in effect made when the individual discounts were deducted from the amounts entered in Vouchers Payable column of the voucher register. It will be observed that one of the principal differences between the two methods of handling cash discounts on purchases is that in the one case discounts are entered in the cash disbursements journal in the usual manner, and in the other they are entered in the voucher register.

Necessary Adjustments.—The second method of recording cash discounts on purchases, by entering the discounts in the voucher register, has one disadvantage. It will be noted that by this system the discounts are entered in the voucher register before the payments are made and the discounts are actually earned. At the end of the fiscal period, therefore, when the books are adjusted and closed, there will be a few vouchers remaining unpaid, but the discounts on them will be entered as though actually paid and earned. All such anticipated or unearned discounts on unpaid vouchers will have to be set up in an adjustment account—one deferring the anticipated income to the next fiscal period, and accordingly to be carried in the statement for the current period as a liability account, or more exactly as an offsetting or contra account. This method of recording cash discounts on purchases is also upset in the event that the firm is unexpectedly prevented from taking the anticipated discounts. An adjustment will then also be required as well as the preparation of a new or additional voucher to cover the discount.

SEASONAL DATINGS AND ANTICIPATION RATES

Anticipation of Regular Discount Term—Handling of Freight Charges—Table of Anticipation Rates and Percentages and Its Use

Dating Terms.—In many seasonal businesses, as certain lines of the dry goods business, for example, in addition to the regular credit period, the buyer is allowed an extra number of days in which to make payment. This is for the purpose of inducing him to place his order early, so as to relieve the seller's rush period and enable him to get information in advance as to the quantity he is likely to be called upon to manufacture.

Suppose, for example, the terms of sale are 2% 10 days, net 30 days, and 60 days extra, or as it may be expressed, 2% 10d./n.30 d./60 d. extra. Under these terms, the regular credit period of 30 days does not begin to run until the extra 60 days have elapsed. The buyer, therefore, may take his cash discount if he pays at the end of 70 days or he may wait for a total of 90 days before he remits the full invoice amount.

If, however, he anticipates the regular discount term, which is 70 days off from the invoice date, he is allowed interest at a per annum rate, customarily used in the trade. Thus if he settles 50 days from the date of the invoice, he will be allowed interest for 20 days. This interest allowance, or anticipation as it is called, is in addition to the regular cash discount of 2%. It is an extra cash discount which is computed on a different basis from that of the regular cash discount.

Terms which include the extra period are referred to as dating terms, due to the fact that to all intents and purposes the invoice is dated in advance by the number of extra days allowed for payment.

Example: Invoice dated March 31 for $4,750.90, terms 2% 10 days, 90 days extra, f.o.b. destination, paid on April 27.

Invoice	$4,750.90
Less: Freight	30.40
	4,720.50
Less: Discount 2%	94.41
	4,626.09
Less: Anticipation 6% for 73 days (1.2%, see accompanying table)	55.51
Amount of check	$4,570.58

In the foregoing example the cash discount was based on the invoice amount less freight. The subtraction of the freight is due to the fact that the goods were quoted f.o.b. destination and the price included the freight. The anticipation was based on the amount left after deduction of the sales discount of 2%.

It is the custom with some stores to compute the discount on the face of the invoice and the anticipation on the net amount after deducting the discount; then deducting the freight charges. This plan, which favors the purchaser, is illustrated below.

Using the same example as shown above, namely, invoice dated March 31 for $4,750.90, terms 2% 10 days, 90 days extra, f.o.b. destination, paid on April 27, the computations are as follows:

Invoice	$4,750.90
Less: Discount 2%	95.02
	4,655.88
Less: Anticipation 6% for 73 days (1.2%, see table)	55.87
	4,600.01
Less: Freight	30.40
Amount of check	$4,569.61

Table of Anticipation Rates and Percentages.—In computing anticipation on invoices, the accompanying table, adapted from the publications of Controllers Congress of National Retail Dry Goods Association, will be of assistance.

A Table of Anticipation Rates and Percentages

Per Annum Rates

Days	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	.00274	.00548	.00822	.01096	.01370	.01644	.01918	.02192	.02466	.02740
2	.00548	.01096	.01644	.02192	.02740	.03288	.03836	.04384	.04932	.05479
3	.00822	.01644	.02466	.03288	.04110	.04932	.05753	.06575	.07397	.08219
4	.01096	.02192	.03288	.04384	.05479	.06575	.07671	.08767	.09863	.10959
5	.01370	.02740	.04110	.05479	.06849	.08219	.09589	.10959	.12329	.13699
6	.01644	.03288	.04932	.06575	.08219	.09863	.11507	.13151	.14795	.16438
7	.01918	.03836	.05753	.07671	.09589	.11507	.13425	.15342	.17260	.19178
8	.02192	.04384	.06575	.08767	.10959	.13151	.15342	.17534	.19726	.21918
9	.02466	.04932	.07397	.09863	.12329	.14795	.17260	.19726	.22192	.24658
10	.02740	.05479	.08219	.10959	.13699	.16438	.19178	.21918	.24658	.27397
11	.03014	.06027	.09041	.12055	.15068	.18082	.21096	.24110	.27123	.30137
12	.03288	.06575	.09863	.13151	.16438	.19726	.23014	.26301	.29589	.32877
13	.03562	.07123	.10685	.14247	.17808	.21370	.24932	.28493	.32055	.35616
14	.03836	.07671	.11507	.15342	.19178	.23014	.26849	.30685	.34521	.38356
15	.04110	.08219	.12329	.16438	.20548	.24658	.28767	.32877	.36986	.41096
16	.04384	.08767	.13151	.17534	.21918	.26301	.30685	.35068	.39452	.43836
17	.04658	.09315	.13973	.18630	.23288	.27945	.32603	.37260	.41918	.46575
18	.04932	.09863	.14795	.19726	.24658	.29589	.34521	.39452	.44384	.49315
19	.05205	.10411	.15616	.20822	.26027	.31233	.36438	.41644	.46849	.52055
20	.05479	.10959	.16438	.21918	.27397	.32877	.38356	.43836	.49315	.54795
21	.05753	.11507	.17260	.23014	.28767	.34521	.40274	.46027	.51781	.57534
22	.06027	.12055	.18082	.24110	.30137	.36164	.42192	.48219	.54247	.60274
23	.06301	.12603	.18904	.25205	.31507	.37808	.44110	.50411	.56712	.63014
24	.06575	.13151	.19726	.26301	.32877	.39452	.46027	.52603	.59178	.65753
25	.06849	.13699	.20548	.27397	.34247	.41096	.47945	.54795	.61644	.68493
26	.07123	.14247	.21370	.28493	.35616	.42740	.49863	.56986	.64110	.71233
27	.07397	.14795	.22192	.29589	.36986	.44384	.51781	.59178	.66575	.73973
28	.07671	.15342	.23014	.30685	.38356	.46027	.53699	.61370	.69041	.76712
29	.07945	.15890	.23836	.31781	.39726	.47671	.55616	.63562	.71507	.79452
30	.08219	.16438	.24658	.32877	.41096	.49315	.57534	.65753	.73973	.82192
31	.08493	.16986	.25479	.33973	.42466	.50959	.59452	.67945	.76438	.84932
32	.08767	.17534	.26301	.35068	.43836	.52603	.61370	.70137	.78904	.87671
33	.09041	.18082	.27123	.36164	.45205	.54247	.63288	.72329	.81370	.90411
34	.09315	.18630	.27945	.37260	.46575	.55890	.65205	.74521	.83836	.93151
35	.09589	.19178	.28767	.38356	.47945	.57534	.67123	.76712	.86301	.95890
36	.09863	.19726	.29589	.39452	.49315	.59178	.69041	.78940	.88767	.98630
37	.10137	.20274	.30411	.40548	.50685	.60822	.70959	.81096	.91233	1.01370
38	.10411	.20822	.31233	.41644	.52055	.62466	.72877	.83288	.93699	1.04110
39	.10685	.21370	.32055	.42740	.53425	.64110	.74795	.85479	.96164	1.06849
40	.10959	.21918	.32877	.43836	.54795	.65753	.76712	.87671	.98630	1.09589
41	.11233	.22466	.33699	.44932	.56164	.67397	.78630	.89863	1.01096	1.12329
42	.11507	.23014	.34521	.46027	.57534	.69041	.80548	.92055	1.03562	1.15068
43	.11781	.23562	.35342	.47123	.58904	.70685	.82466	.94247	1.06028	1.17808
44	.12055	.24110	.36164	.48219	.60274	.72329	.84384	.96438	1.08493	1.20548
45	.12329	.24658	.36986	.49315	.61644	.73973	.86301	.98630	1.10959	1.23288
46	.12603	.25205	.37808	.50411	.63014	.75616	.88219	1.00821	1.13424	1.26027
47	.12877	.25753	.38630	.51507	.64384	.77260	.90137	1.03013	1.15890	1.28767
48	.13151	.26301	.39452	.52603	.65753	.78904	.92055	1.05205	1.18356	1.31506
49	.13425	.26849	.40274	.53699	.67123	.80548	.93973	1.07397	1.20821	1.34246
50	.13699	.27397	.41096	.54795	.68493	.82192	.95890	1.09589	1.23287	1.36986
51	.13973	.27945	.41918	.55890	.69863	.83836	.97808	1.11780	1.25753	1.39726
52	.14247	.28493	.42740	.56986	.71233	.85479	.99726	1.14146	1.28219	1.42465
53	.14521	.29041	.43562	.58082	.72603	.87123	1.01643	1.16164	1.30684	1.45205
54	.14795	.29589	.44384	.59178	.73973	.88767	1.03561	1.18356	1.33150	1.47945
55	.15068	.30137	.45205	.60274	.75342	.90411	1.05479	1.20547	1.35616	1.50684

A TABLE OF ANTICIPATION RATES AND PERCENTAGES—(*Continued*)

PER ANNUM RATES

Days	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
56	.15342	.30685	.46027	.61370	.76712	.92055	1.07397	1.22739	1.38082	1.53424
57	.15616	.31233	.46849	.62466	.78082	.93699	1.09315	1.24931	1.40547	1.56164
58	.15890	.31781	.47671	.63562	.79452	.95342	1.11232	1.27123	1.43013	1.58904
59	.16164	.32329	.48493	.64658	.80822	.96986	1.13150	1.29315	1.45479	1.61643
60	.16438	.32877	.49315	.65753	.82192	.98630	1.15068	1.31506	1.47945	1.64383
61	.16712	.33425	.50137	.66849	.83562	1.00274	1.16986	1.33698	1.50410	1.67123
62	.16986	.33973	.50959	.67945	.84932	1.01918	1.18904	1.35890	1.52876	1.69863
63	.17260	.34521	.51781	.69041	.86301	1.03562	1.20821	1.38082	1.55342	1.72602
64	.17534	.35068	.52603	.70137	.87671	1.05205	1.22739	1.40273	1.57808	1.75342
65	.17808	.35616	.53425	.71233	.89041	1.06849	1.24657	1.42465	1.60273	1.78082
66	.18082	.36164	.54247	.72329	.90411	1.08493	1.26573	1.44657	1.62739	1.80821
67	.18356	.36712	.55068	.73425	.91781	1.10137	1.28493	1.46849	1.65205	1.83561
68	.18630	.37260	.55890	.74521	.93151	1.11781	1.30410	1.49041	1.67671	1.86301
69	.18904	.37808	.56712	.75616	.94521	1.13425	1.32328	1.51231	1.70136	1.89041
70	.19178	.38356	.57534	.76712	.95890	1.15068	1.34246	1.53424	1.72602	1.91780
71	.19452	.38904	.58356	.77808	.97260	1.16712	1.36164	1.55616	1.75068	1.94520
72	.19726	.39452	.59178	.78904	.98630	1.18356	1.38082	1.57808	1.77534	1.97260
73	.20000	.40000	.60000	.80000	1.00000	1.20000	1.40000	1.60000	1.80000	2.00000
74	.20274	.40548	.60822	.81096	1.01370	1.21644	1.41917	1.62191	1.82465	2.02739
75	.20548	.41096	.61644	.82192	1.02740	1.23288	1.43835	1.64383	1.84931	2.05479
76	.20822	.41644	.62466	.83288	1.04110	1.24931	1.45753	1.66575	1.87397	2.08219
77	.21096	.42192	.63288	.84384	1.05479	1.26575	1.47671	1.68767	1.89863	2.10958
78	.21370	.42740	.64110	.85479	1.06849	1.28219	1.49589	1.70958	1.92328	2.13698
79	.21644	.43288	.64932	.86575	1.08219	1.29863	1.51506	1.73150	1.94794	2.16438
80	.21918	.43836	.65753	.87671	1.09589	1.31507	1.53424	1.75342	1.97620	2.19183
81	.22192	.44384	.66575	.88767	1.10959	1.33151	1.55342	1.77534	1.99726	2.21917
82	.22466	.44932	.67397	.89863	1.12329	1.34794	1.57260	1.79726	2.02191	2.24657
83	.22740	.45479	.68219	.90959	1.13699	1.36438	1.59178	1.81917	2.04657	2.27397
84	.23014	.46027	.69041	.92055	1.15068	1.38082	1.61095	1.84109	2.07123	2.30136
85	.23288	.46575	.69863	.93151	1.16438	1.39726	1.63013	1.86301	1.09589	2.32867
86	.23562	.47123	.70685	.94247	1.17808	1.41370	1.64931	1.88493	2.12054	2.35616
87	.23836	.47671	.71507	.95342	1.19178	1.43014	1.66849	1.90684	2.14520	2.38356
88	.24110	.48219	.72329	.96438	1.20548	1.44657	1.68767	1.92786	2.16986	2.41095
89	.24384	.48767	.73151	.97534	1.21918	1.46301	1.70684	1.95068	2.19452	2.43835
90	.24658	.49315	.73973	.98630	1.23288	1.47945	1.72602	1.97260	2.21917	2.46575

The annual rates have been reduced in this table to a daily basis. The table is based upon 365 days to the year, and covers annual rates from 1% to 10%, and periods from 1 to 90 days.

To find the anticipation rate to be applied when the annual rate is 6% and the number of days of the anticipation is 73, it is only necessary to locate the figure in the 6% column opposite the figure 73 in the "Days" column, which is 1.2%. This percentage applied to the invoice amount or other basis taken gives the amount of the anticipation.

TRADE DISCOUNTS

List or Gross Prices—Discount Sheets—Purpose of Trade Discounts—Quantity Discounts—Table of Chain Discounts

Definition and Purpose.—Trade discounts are deductions which merchants allow dealer customers from their list prices as given in their catalogs, for the various articles they handle. It is customary to express the discounts as percentages on list prices. The list or gross prices less the discounts are the actual sales prices at which the articles are offered to customers, or the so-called net selling prices. In addition to the catalog with the list prices, dealers are supplied separate sheets, called discount sheets, which show the trade discounts to be applied to the list prices for the various articles. The articles are identified in the discount sheets by their catalog numbers. For example, the merchant may list commodity numbered 45 in the catalog at $500, but in the discount sheet he may allow a trade discount of 10% on the article. The net selling price of the article is 90% of $500, or $450.

The custom of using trade discounts serves several purposes. The list or catalog prices may be the retail prices at which the articles are sold, while the net prices, or the list prices minus the discounts, are those at which the articles are offered to dealers. More important, in most industries using trade discounts, the opportunity is afforded by the use of trade discounts of changing the selling price of an article to meet fluctuations in market prices by making a change in the discount sheet instead of revising the catalog. Effecting changes in catalogs is more expensive than making the same changes in the discount sheets containing merely the catalog numbers for the articles and the trade discount. Trade discounts are also used for the purpose of partly concealing the real quotation. Without the discount sheet giving the rates of discount allowed from list prices, the catalog reveals little concerning the real prices.

"Quantity discounts" allowed from regular selling prices on goods purchased in large quantities are also a form of trade discount. The practice of showing sales prices by means of a list price with trade discounts is not universal, however. Some trades do not favor it.

It is customary to enter trade discounts on sales invoices. The list price is first set up and the discounts deducted, giving the net selling price, or the amount with which the customer is charged on the books. The net selling price is the usual basis for computing any cash discount allowed the customer.

Chain Discounts.—Trade discounts are used singly or in series or chains. An article may have one discount rate or it may have several. In the latter case, the net selling price is determined by applying the first rate to the list price, then each of the successive rates to the net amount resulting from the application of the previous rate. Suppose an article listed in the catalog at $750 has a discount series in the discount sheet of 33⅓%, 10%, and 5%. The net selling price is computed by taking 66⅔% of $750, which gives $500; 90% of $500, which gives $450; 95% of $450, which gives $427.50, the net selling prices.

Method 1		*Method 2*
$750	List price	$750 .33 1/3
.66 2/3	Less 33 1/3 (1st disc.)	$250
$500	1st balance	$750 Less 250
.90	100% less 10% (2nd disc.)	$500 .10
$450	2nd balance	$50
.95	100% less 5% (3rd disc.)	$500 Less 50
$427.50	Net selling price	$450 .05
		$22.50
		$450.00 Less 22.50
		$427.50

The computation may be made by either of the preceding methods.

Cumulative or chain discounts are a necessary device for following the rise and fall of market prices. As the market falls, the trade discount rises.

Short Methods of Calculation.—Short methods for calculating trade discounts when given in a series or a chain are often employed. For a series of only two discounts, a single rate equivalent to the two may be found by subtracting their product from their sum—always treating them as decimals. Thus, a series of 20 and 20 is equivalent to a single rate of 36 as follows: ($.20 + .20 = .40$; $.20 \times .20 = .04$; $.40 - .04 = .36$).

Where there are many such chain discounts to be computed, it is well to have the clerk prepare a table like the following taking into consideration the usual discounts that are given in the particular trade.

TABLE SHOWING NET EQUIVALENT AFTER CHAIN DISCOUNTS

	5%	10%	12½%	16⅔%	20%	25%	33⅓%
Net	.95000	.90000	.87500	.83333	.80000	.75000	.66667
2½%	.92625	.87750	.85313	.81250	.78000	.73125	.65000
5%	.90250	.85500	.83125	.79167	.76000	.72150	.63333
10%	.85500	.81000	.78750	.75000	.72000	.67500	.60000
10%, 5%	.81225	.76950	.74813	.71250	.68400	.64125	.57000
20%	.76000	.72000	.70000	.66667	.64000	.60000	.53333
20%, 5%	.72200	.68400	.66500	.63333	.60800	.57000	.50667
20%, 10%	.68400	.64800	.63000	.60000	.57600	.54000	.48000
20%, 10%, 5%	.64980	.61560	.59850	.57000	.54720	.51300	.45600
25%	.71250	.67500	.65625	.62500	.60000	.56250	.50000

RECORDING TRADE DISCOUNTS

Trade Discount Allowances Account—Treatment in Profit and Loss Statement—Record Made on Seller's and Customer's Books

On Seller's Books.—Where a concern extends trade discounts to all customers, it will uniformly record sales at the net selling prices, that is, at the list prices less the trade discounts allowed. The trade discounts will thus be entirely ignored in making the formal book entries. The only records of them may be the invoices, and the customers' discount file. If, however, a business sells at list to retail customers, and at net to dealers, all sales will be entered at list, but in the case of sales made at net prices, an account called Trade Discount Allowances, or bearing some similar title, will at the same time be debited with the dollar amounts of the discounts. A column will be provided in the sales journal for entering the amount of the discount on each sale, the total of which at the end of the month will be posted as a debit to Trade Discount Allowances, while the net amount of the sales invoice will be posted to the debit of the customers' accounts. At the close of the fiscal period, when the final statements are drawn up, the total is shown on the profit and loss statement as a deduction from gross sales, giving the total net sales. The treatment is thus equivalent to a sales allowance.

On Customer's Books.—Ordinarily buyers who purchase merchandise or materials at prices subject to trade discounts, charge Purchases or the individual merchandise or materials accounts at the net invoice price—the list price less the trade discounts. It is the policy of some concerns, however, to carry the inventory at the gross price and consider the trade discount as financial earned income, credit for which is given the purchase department. In such instances, merchandise or materials are charged at the gross price, while the seller is credited with the net amount and an Earned Trade Discount account with the amount of the discount. A column is provided in the purchase journal in which the discount on each purchase is entered from the invoice as received or the voucher if the voucher system is employed. When the postings are made at the close of the month, the total of the column is credited to an Earned Trade Discount account. Trade discounts being viewed in such instances as income, the account recording them, "Earned Trade Discounts," will be balanced and closed at the end of the accounting period, and its balance will appear on the profit and loss statement in the section composed of the Financial Management or Other Income items.

RECORDING ANTICIPATION

Entries on Vendor's and Purchaser's Books—Treatment on Vendor's and Purchaser's Profit and Loss Statements

Entries on Seller's Books.—Where dating terms, or extra credit periods, are allowed customers, the anticipation or interest allowed them for anticipating all or a portion of the extra period is a financial expense to the seller, in addition to the regular cash discount allowed. In every case where anticipation is allowed, the regular cash discount is allowed also, since the anticipation can only take effect after the customer has earned his cash discount.

While these two classes of discounts or financial expense might be lumped together and treated as one on the seller's books, and handled as ordinary cash discounts, it is customary to keep a separate anticipation account. The cash receipts journal, therefore, will have a discount column for anticipation in addition to the one for the ordinary cash discount. When the anticipation is taken by the customer, he will indicate the deduction on the invoice he sends back with his remittance, or on the voucher check if he uses one. Upon receipt, the seller enters the amount of the remittance in the net cash column of the cash receipts journal, the cash discount in the cash discount column, and the anticipation in the anticipation column. When the cash receipts journal is posted at the close of the month, the total of the anticipation column is debited to an account entitled Anticipation Allowances, or Anticipations Allowed, while the individual amounts composing the total are credited to customers' accounts.

Anticipations allowed by sellers are a financial expense and the account is balanced and closed at the end of the fiscal period when the books are closed. The balance will appear in the Financial Management section of the profit and loss statement, along with interest and rent paid, cash discounts allowed, and similar items.

Entries on Customer's Books.—The customer, on the other hand, when he deducts the anticipation from the invoice amount, enters it in a column provided for the purpose in the cash disbursements book. At the same time he enters the cash discount, which he also takes, in the Cash Discount column and the amount of the remittance in the Net Cash column. When posting at the end of the month, he credits the total of the Anticipation column to Anticipations Earned or an account bearing a similar title, and debits the individual items composing this total to the respective creditors' accounts.

The anticipations earned by buyers are a species of financial income, and when the books are closed, the account is balanced and closed like any other income account. Its credit balance appears separately or is lumped with other financial income items, such as interest or rent received, or cash discounts earned, in the Financial Management Income section of the profit and loss statement.

PETTY CASH—IMPREST FUND SYSTEM

General Operation of System—Methods of Entering Charges for Expenditures—When Several Cash Funds Are Established

Methods of Handling Petty Cash.—A certain amount of actual currency is necessary in every office for the purpose of making change, cashing checks, making minor disbursements, for items such as traveling expenses, postage, express and C.O.D. charges, and for payment of small purchases from concerns with which no current accounts have been opened. There are two standard methods of handling such petty cash funds—the imprest fund system, which requires no petty cash book, and one in which a petty cash book is used (see page 113). The former of the two methods is preferred because of its facilitating better control of the fund.

General Operation of Imprest Fund System.—Under the imprest fund method, the petty cash fund is always replenished for an amount equal to expenditures represented by receipts or vouchers, not as yet charged to the accounts, so

PETTY CASH ORDER

No.________

To Cashier: ______________ 19___

Pay to ____________________________ $________

Charge ______________________________________

Received Payment: BLANK MANUFACTURING CO.

__________________ __________________________

Petty Cash Slip

that it is constantly maintained at a fixed amount on the general ledger. The fund is created by drawing a check for a round sum varying from $10 to $500 to the order of the petty cashier, who cashes it at the bank. The general ledger account charged through the cash disbursements book or check register is "Imprest Petty Cash Fund," or simply "Petty Cash." The petty cashier is required to secure a receipted bill, sales ticket, or some other properly authorized voucher for every item of expenditure from the fund (see form above, so that at all times the amount of cash in his possession added to the receipted bills or vouchers must equal the original amount in the fund. As the unexpended portion of the fund becomes low, the petty cashier presents his receipted bills together with a summary thereof to the general accounting department, and receives a check for the total amount of the summary. The fund is thus restored to its original fixed amount.

Suppose, for example, $50 is the amount of cash deemed necessary to take care of petty expenditures for a month and that is the amount of the check drawn to inaugurate the petty cash fund. At the end of the month, the petty cashier has expended and secured receipts for $47.50. He turns over these receipts to the general cashier and receives a check for $47.50. This amount, together with his balance of $2.50, gives him once again a fund of $50.

Methods of Making Entry.—Each receipted bill or voucher, as well as the summary, shows the account to be charged for each expenditure, and entry is made by any one of the following three methods:

1. Charges are made to the several accounts through the general cash book, their total offsetting the check replenishing the petty cash. By this method no charge appears in the "Petty Cash" account except for the item covering the original check. In other words, the "Petty Cash" account only contains the original entry for the amount of the check creating the fund, and remains unchanged except when it is adjusted through the cash book or check register for any increases or decreases in the fixed amount of the fund.

2. An entry is made through the journal debiting the various expenses and crediting Petty Cash. This latter method necessitates charging in the general cash book each replenishing check to Petty Cash as an offset to the journal credit of the same amount.

3. Where the voucher system is employed, or where all purchases are passed through the purchase journal, the charges for the petty expenses are made through the voucher register or the purchase journal. Accounts Payable or Vouchers Payable is then debited in the check register with the amount of

the replenishing check, the bank account being credited. This method is similar to the first in that the Petty Cash account remains unchanged.

Most accountants prefer the first or third of these three methods, as they consider the postings to Petty Cash unnecessary—except the original posting when the fixed fund is established or is changed.

Several Cash Funds.—In certain lines of business, as the hotel business or the large department store, there may be a number of cashiers in charge of cash funds. Also special funds may be established for particular purposes, as those set up to provide salesmen with traveling expense money, all conducted on the imprest basis. When this is the case, there should be a separate account on the general ledger for each fund. This method is also used in instances where the firm has separate petty cash funds with each of its branches.

PETTY CASH BOOK

Petty Cash Book as a Subsidiary Ledger—Summarization and Posting of Petty Cash Book—General Cash Receipts and Petty Cash Fund

Operation of System.—Where the imprest fund system is not used in handling petty cash, a petty cash book is used. According to this method, what is in reality a subsidiary ledger—the petty cash book—controlled by the "Petty Cash" account in the general ledger, is used. Checks are drawn for varying round amounts from time to time as needed, and are charged to the Petty Cash account. Provision is made in the petty cash book for entering the proceeds of such checks in one column and the disbursements in a number of other columns. At the end of each month, a journal entry is made crediting the "Petty Cash" account for the total disbursements, while the respective expense accounts are debited with the totals of the distribution columns provided for the classification of the expenses. The balance of the fund as shown by the adjusted balance in the general ledger account should agree with the petty cash book balance. When this method of handling petty cash is used, petty cash vouchers, orders, or receipts may be dispensed with when the amounts disbursed are small and the entries are so explanatory as to indicate clearly that proper payments have been made. A form of petty cash book appears below. It is columnized to provide for

PETTY CASH DISBURSEMENTS

DATE	RECEIVED CK. NO.	RECEIVED AMOUNT	VO. NO.	PAID TO	FOR	CREDIT TOTAL	DEBIT POSTAGE	DEBIT CARFARE	DEBIT EXPRESS	DEBIT MISCELL.
19-- July 2	492	50 00	1	T. Green	Stamps	3 00	3 00			
3			2	L. Taylor	Pads & Ink	1 85				1 85
6			3	U. Dennis	R.R. to Yonkers	58		58		
7			4	J. Calkins	Bulbs	4 86				4 86
10			5	R. Bailey	Am. Exp.	90			90	
						11 19	3 00	58	90	6 71
				Cash Balance		38 81				
		50 00				50 00				

Petty Cash Book

entry of the date, the amount of the check, check number, the serial number of the petty cash voucher, explanation of the disbursements, the total credit to Petty Cash, and the expenses to be debited. The entry summarizing the expenses and crediting Petty Cash may be made in the petty cash journal, or it may be made in the general journal. In the latter case the petty cash journal becomes merely a memorandum book.

General Cash Receipts and Petty Cash Fund.—Where petty cash transactions are few, payments are sometimes made from currency included in the daily receipts. This is poor practice, however, as the daily bank deposits will then be less than the current entries shown in the cash received book and offsetting entries must be made in the check register or cash payment book which are not actually represented by checks. All receipts, except stamps (see page 12) should be deposited in the bank and no part of them be used for petty cash disbursements.

FACTORY PAYROLL

Entering Time Tickets on Payroll—Routine in Closing the Payroll—Several Methods of Recording Payroll

Labor Time Ticket.—The key form in accounting for labor in a manufacturing company, where employees are paid by the hour, is the labor time ticket, as shown on page 304. A time ticket is issued daily for each employee, on which the field timekeeper or departmental clerk in the factory enters the number of hours the employee has worked that day, how those hours were distributed between different jobs, if the factory is operating on a cost accounting basis, the rate of payment, and other required data. Through these tickets all the information needed to account for the cost of labor is provided. They are sent daily to the accounting department, where they are sorted and resorted so as to abstract from them any desired information.

The time tickets are entered daily upon the payroll, which is a form used for compiling the wages due each employee for a specified period—usually a week. The form on page 116 illustrates a payroll form for a factory set-up for one week ending with the date indicated.

Closing the Payroll.—After all the time tickets for a week have been entered in the payroll, the roll is closed. The routine is as follows:

1. Total the hours of each man listed and enter the total in the Total Hours column. Add these totals and enter the sum as shown in the payroll illustrated.

2. Enter each man's rate in the rate columns. Multiply his total hours for the week by his rate in order to obtain his gross earnings. Record these earnings in the Gross Earnings column and add them. Enter the total as shown in the illustration.
3. Usually there are some deductions to be taken from the gross earnings before paying the employees. They may, for example, live in company houses and pay rent and may deal at the company store maintained for their convenience. Ordinarily each service is conducted by a separate organization which maintains its own books. Before each pay day, each of these service organizations renders the payroll department a statement of the amounts which employees owe for service. Each worker's indebtedness is deducted from his pay and placed to its credit. To record deductions on the payroll, enter the amount of each employee's indebtedness in the proper column opposite his name. Subtract each man's deductions from his gross earnings to determine the net earnings. Enter the net earnings in the Net Earnings column and foot the column.
4. Prove total net earnings: Total gross earnings minus total deductions equal total net earnings.

After the payroll is completed, the labor cost of the week's operations is entered on the general ledger by issuing a voucher, if the voucher system is used, for the total amount of gross earnings and entering it in the voucher register. The entry consists of charges to Labor in Process and Factory Expense, where a cost accounting system is in operation, and setting up a liability for net wages due the workers and the amounts due the service organizations.

The same entries may be made instead in the purchase journal where all expenditures, whether of material, labor, expense, etc., are passed through that journal. Again, instead of passing the payroll through the voucher register or the

PAYROLL

For Week Ending January 31, 19–

Name and Number	25 M	26 T	27 W	28 Th	29 F	30 S	31 Sun	Total Hours	Rate	Gross Earnings	Rent	Store	Net Earnings
Brought Forward								366		$228.40	$56.00	$36.00	$136.40
9 John Jones	8	8	8	8	8	8		48	60¢	28.80			28.80
10 Fred Williams	8	8	8	8	8	8		48	60¢	28.80	8.00	5.00	15.80
11 Jack Wilson	8	8	8		8	8		40	50¢	20.00		4.00	16.00
12 William Johnson	8	8	8	8	8	8		48	50¢	24.00			24.00
13 James Lewis							6	6	60¢	3.60			3.60
								(556)		(333.60)			
13 James Lewis, Sweeper							2	2	50¢	1.00			1.00
14 J. Smith, Laborer	8	8	8	8	8	.5		40.5	50¢	20.25			20.25
15 F. Linn, Clerk	8	8	8	8	8	8		48		30.00			30.00
16 L. Thomas, Foreman	8	8	8	8	8	8		48		50.00			50.00
										(101.25)			
										$434.85	$64.00	$45.00	$325.85

Form of Factory Payroll

purchase journal, the entries are not infrequently posted to the general ledger account direct from the payroll itself, which then performs the function of a journal and is in fact sometimes referred to as the payroll journal. On the other hand, many accountants use the labor summary for each department as the posting medium which shows in separate columns the total hours and the total labor cost on each of several jobs, day by day, for the period taken. In a concern not operating under any cost system, the payroll is passed through the cash book or cash disbursements journal and posted to Payroll account in the general ledger.

Making Payments.—The payroll in a large concern is a frequent source of error and fraud, and therefore requires special safeguards. It should be checked as to mathematical correctness, and also as to content of the roster, where possible, both before and after making payment.

If payment is in currency, this will be secured by check on the bank and the pay envelopes made up from it. Before drawing the currency, the individual amounts should be analyzed to determine the denominations of the coins and currency needed for filling each envelope. On each pay envelope should be marked the name and the amount. One payroll clerk should count out the amounts, and another clerk verify them and fill the envelopes. A payroll machine is often used for filling envelopes with the proper amount. When the envelopes are delivered to the workmen, each man should identify himself in the presence of his foreman. The clerks making payment and the witnessing foreman should sign the payroll. Any unclaimed envelopes are returned to the treasurer to be held a certain length of time for claiming, after which time liability for them must still be shown on the books as Unclaimed Wages.

Special Payroll Records in Connection with the Social Security Act.—The Social Security Act passed by Congress in 1935, together with the supplementary enactments which the several states may adopt, as contemplated by the federal law, impose upon bookkeepers special duties in connection with the payroll records. The federal law provides for old-age and unemployment benefits for employees, the cost of which is to be borne partly by the employers and partly by the employees in the shape of taxes based on the payroll and paid by the employers to the government. For the purpose of aiding the administration of the law, employers must maintain special payroll records on forms prescribed by the government, and must submit annual reports to the government which will in effect show how the amount of the tax paid was arrived at.

PAYROLL RECORDS OF A SMALL CONCERN

Use of Time and Payroll Book—Various Forms of Pay Envelopes—Payroll Analysis of Currency Sheet

Time Book or Card.—Payroll is a business term referring to the list of the employees and the amounts that are due them for wages. In order to ascertain the amounts they have earned each period, usually each week, it is the practice to record the time they have served in a time book or on a time card. A list of names of the employees is written in the time book, together with their numbers if any are assigned, and the title of the position each occupies. The book is so arranged that the amount of time served each day of the week may be listed in appropriate columns opposite the name of each employee.

Payroll Book or Sheet.—The payroll book or sheet frequently consists of a time book and a pay book. The form shown opposite is used where the number of employees is not large. The columnar arrangement of the payroll book provides space for entry, besides the working time, the wage rate per hour, and the total amount earned for the week. The names on the payroll are usually grouped by operating departments or according to the nature of the work being done. Space may also be provided for the employee's signature when receiving his pay, but this may be given on a separate receipt. Payrolls when completed and paid are usually placed in a file in the safe so as to make them accessible only to authorized persons.

PAYROLL WEEK ENDING AUGUST 15, 19–

No.	M	T	W	T	F	S	Total Hrs.	Per Hr.	Amount
1. H. Hill	9	9	9	9	9	9	54	$.50	$27.00
2. J. Jones	8	–	8	8	8	8	40	.50	20.00
3. P. Black	9	8	7½	9	9	9	51½	.40	20.60
4. S. Sherman	9½	8½	7	8	8	8	49	.60	29.40
5. T. Main	6¾	8¼	9	9	9	9	51	.55	28.05
6. S. Glass	8	8	8	8	8	8½	48½	.30	14.55
									$139.60

Payroll Sheet

When the payroll for a particular period is totaled, it may be used as a posting medium for charging the Payroll account and crediting Payroll Accrued. When a check is cashed for the amount of the payroll, Payroll Accrued is debited and Cash is credited.

Pay Envelopes.—When the payroll is made and each employee's earnings for the period ascertained, it is frequently necessary to prepare the payroll envelopes, one form of which is shown below. Such envelopes bear the name and number of the employee, and the amount of money enclosed in the envelope. To facilitate the making up of the envelope, it is well to obtain the proper denominations of bills and currency from the bank. For this purpose an analysis may be made of the amounts of the wages earned into the denominations required for their payment on a separate sheet,

No. 3 Hrs. 51½

Name P. Black

$ 20.60

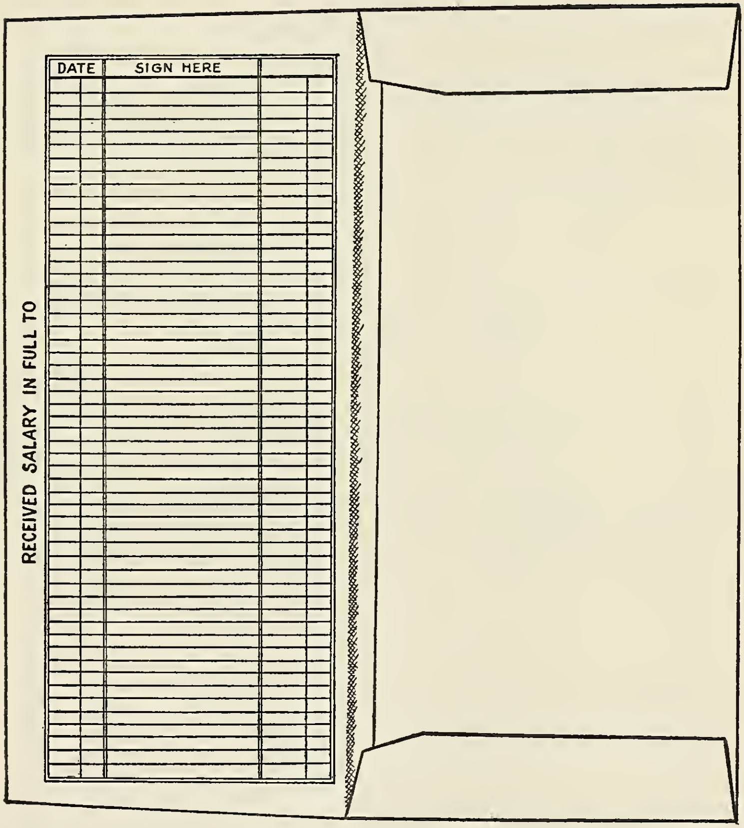
Payroll Envelope

similar to the one shown below, and then the columns may be added to find the total number of bills and coins of each denomination which the entire payroll requires.

No.	Amount	$10	$5	$1	H.	Q.	D.	N.	P.
1.	$27.00	2	1	2					
2.	20.00	2							
3.	20.60	2			1		1		
4.	29.40	2	1	4		1	1	1	
5.	28.05	2	1	3				1	
6.	14.55	1		4	1			1	
	$139.60	11	3	13	2	1	2	3	

Payroll Analysis of Currency Sheet

Instead of a temporary paper envelope, which the employee discards upon receipt, a permanent linen envelope bearing the name of the employee and the department in which he is employed may be used repeatedly on each pay day. The



Linen Pay Envelope, Showing the Inside of the Flap, ruled to receive the Employee's Signature inside of the flap is ruled to provide space for the date of each payment, the employee's signature, and the amount of pay. Upon receiving the envelope, the employee extracts the cash from it, signs the flap and returns the envelope to the cashier for use on the following pay day. The accompanying form illustrates such a pay envelope.

Instead of paying wages in cash enclosed in envelopes, some firms not infrequently hand employees payroll checks on a particular bank, with which special arrangements are made for the payment of the payroll.

OFFICE AND SALES PAYROLLS

Vouchering of Payroll—Form of Payroll in Small Organization —Employee's Signature on Payroll

The office and sales payrolls are kept separate from the factory payroll, since the factory cost records are not concerned with office and sales salaries, which are charged to the appropriate general ledger expense accounts. The office and sales payroll may be ruled in the same manner as the factory roll, as illustrated in the form on page 116, in order to compile each clerk's or officer's time, except that fixed salaries are more common than hourly rates in the office and sales department. At the close of each pay period, the roll is vouchered and entry is made in the voucher register, or it is passed through the general journal. On the other hand, where a simpler system of accounting is employed, the salary roll is entered in the cash disbursements journal and posted to Salaries in the general ledger. For a form of office payroll in a small organization, an arrangement such as shown in the form below might be used. The form provides a column for the signature of the employee, when the salary is paid him. When he is asked to sign, the column is folded over so that the salaries of the other employees may not be seen.

THE H. J. BROWN COMPANY, INC.
GREENVILLE, N. Y.

WEEKLY PAYROLL FOR THE WEEK ENDING August 15, 19—

NO.	EMPLOYEE	WEEKLY SALARY	NO. DAYS	PAYMENT	NO.	SIGNATURE
1	G. Jones	30.00	6	30.00	1	G. Jones
2	H. Brown	35.00	6	35.00	2	H. Brown
3	J. Greene	20.00	6	20.00	3	J. Greene
4	I. Grey	25.00	6	25.00	4	I. Grey
5	F. Black	36.00	5	30.00	5	F. Black
6					6	
7					7	
8					8	
9					9	
10					10	
11					11	
12					12	
TOTAL						

COMPILED BY H. Doe ASST. TREAS. PAID Aug. 15, 19—
CK.# 1492 FOR 140.00
AUDITED BY J. Blank AUDITOR CHARGE Salaries

Office Payroll

PAYROLL BANK ACCOUNT

Use of Special Forms of Checks—Entries to Record Payroll—Payroll Check-Book

Opening of Special Payroll Bank Account.—If a large number of employees are paid by check, a special payroll bank account is opened. On each pay day a voucher is prepared for the total payroll and a check in the regular bank account is drawn and deposited in the payroll bank account. Individual payroll checks are then drawn on the special account and delivered to employees. As a protection against raising the amount on such wage checks, the check form may have engraved or printed on its face a legend limiting the amount payable in the check, as "Not good if over $200." Another legend at times carried by the wage check is "Void thirty days from date." Such provision on the checks causes them to be promptly cashed. If both the regular bank account and the special payroll bank account are in the same

PAYROLL CHECK BOOK									
NAME	CHECK NO.	SALES-MEN'S SALARIES		OFFICE SALARIES		OFFICER'S SALARIES		TOTAL	
H. S. Godwin	101					350	.—	350	—
L. M. Homer	102			150	—			150	—
S. S. Blanchard	103					400	—	400	—
P. T. Sterns	104	280	—					280	—
B. A. Conant	105	300	—					300	—
T. A. Foster	106			125	—			125	—
		580	—	275	—	750	—	1,605	—

Payroll Check-Book

bank, checks on them should be distinguished by different colors and forms.

Recording Payroll.—The entries for the payroll are as follows. In the voucher register, an entry debiting Payroll Bank account and crediting Vouchers Payable is made. In the cash disbursements journal, or the check register, an entry debiting Vouchers Payable and crediting Cash is made. In the journal, Payroll is debited and Payroll Bank account credited. The explanation to the journal entry may refer to a "payroll check-book" showing the distribution of the payroll among the individual employees, with columns for the amounts, one for each department in which the workers are employed. (See form above.)

ITEMS TREATED AS CASH

Treatment of Stamps Received and I.O.U.'s—Handling of Non-Cash Items—Notes Receivable and Drafts

Cash Items.—Checks, express and postal money orders, currency, stamps, notes and acceptances receivable, sight drafts and time drafts, are all in the nature of receipts but not all are cash receipts, nor equally available as current funds. Checks, express and postal money orders, currency and stamps should be handled as cash receipts through the office cashier. Stamps should be exchanged by the office cashier for currency from the petty cash fund in the manner explained on page 12. Under no circumstances should the cashier carry any I.O.U.'s, uncashed checks, receipts for temporary advances, or any miscellaneous memoranda, as part of his fund. If any one is entitled to cash, he should get a proper written authorization and deliver it to the cashier at the time the cash is paid him. That written authority should be immediately attached to the petty cash voucher (see page 110) and be handled in the regular way.

Non-Cash Items.—Notes and acceptances receivable are not cash receipts and should not be handled through the cashier, but should go to the accounting department where they should be immediately entered on the notes and acceptances records and be credited to the customers' accounts. Sights drafts and time drafts receivable, drawn on customers, will originate in the accounting department, and will not be handled by the cashier at the time of issuance, but be placed with the bank for collection. The proceeds from the sight drafts or any discounted time drafts may be entered in the cash receipts book by the accounting department if they are handled directly with the bank and the proceeds entered on the bank deposit book as separate deposits from the regular receipts which pass through the hands of the cashier. If, however, the practice is adopted of requiring all incoming funds to be handled through the cashier, it will be necessary to prepare separate remittance sheets showing the details of the proceeds from sight and time drafts, which should be routed to the bookkeepers in order to make the proper entries. If the major portion of the business is done on a sight draft basis, the simplest method of handling these transactions is to treat the debtors' accounts as ordinary accounts receivable until the sight drafts are actually paid, and when recording the payments of the drafts in the general cash receipt book to make a memorandum, for reference purposes, of the numbers of the drafts paid. The drafts may be drawn in duplicate and the copies of the unpaid drafts may be arranged alphabetically to form the office record of the drafts still in process of collection.

PURCHASE REQUISITION

Purpose and Form of the Requisition—How Issued and Approved in Various Lines of Business

Issuance and Approval of Purchase Requisition.—In a large and well-organized business, all purchases are concentrated in a single department under the direction of a purchasing agent. This rule applies not only to merchandise but also to supplies of all kinds, equipment, and other purchases. The purchasing agent gets his authority to proceed with purchases from the purchase requisitions he receives, which give him the necessary specifications.

The purchase requisition or request initiates the entire purchasing procedure. It may be filled out by various persons. One for office supplies may, for example, be made out by a clerk and approved by the office manager. In the case of merchandise, the requisition may be prepared when the stock of a particular article falls below a fixed minimum quantity. This may be done by a clerk in charge of the cards on which the quantities of various kinds of materials in the storeroom are entered.

The requisition should be approved by some one in authority before being sent to the purchasing agent. In a large retail organization it may be the merchandise manager. In a manufacturing plant, the requisition may be issued by the storeskeeper when he discovers that the supply on hand of the particular article is below the minimum amount he is expected to carry, or by the production or planning department in the form of a "bill of materials." One copy of the purchase request is forwarded to the purchasing department; another is retained by the department making the request. When the request originates outside the storeroom, a third copy of it is sometimes forwarded to the stores department.

R. H. SMITH & COMPANY

Requisition No. L584 Date Jan. 10, 19—

Please purchase for delivery before Feb. 15, 19—

QUANTITY	DESCRIPTION
100 Sheets	14 oz. Hot Rolled Sheet Copper 14″ x 48″
300 Sheets	#9 Gauge Rolled Zinc—36″ x 84″

Requisitioned by Approved by

PURCHASING AGENT'S MEMORANDUM OF ORDER

Purchase Order No. 084 Issued to The Green Metal Co.

Date of Order Jan. 10, 19— Detroit

Purchase Requisition

Form of Purchase Requisition.—A form of a purchase requisition is shown above. When filled out it bears the date of issuance and the serial number given it for identification purposes. It specifies the kind and quantity of the materials or merchandise to be purchased, and the date before which delivery should be made. It is signed by the persons who issues it and by the one approving it. Appropriate space is also allowed in the purchase requisition for the purchasing agent to insert the name of the firm to which a purchase order for the materials specified has been mailed, and the number and date of the purchase order.

PURCHASE ORDER AND PURCHASING PROCEDURE

Form and Content of a Purchase Order—Number of Copies Prepared and How Handled—Blanket Form of Purchase Contract

Purchasing Procedure.—In a well-organized business, all purchasing is made through the purchasing agent or department, so as to facilitate closer control of all purchases. The purchasing agent's authority to initiate a purchase is the purchase requisition or request approved by some one in authority and setting forth the purchase requirements. When the purchase requisition is received, the purchasing agent makes out, in accordance with the requirements specified in the requisition, a purchase order, which he sends to the vendor of the particular articles. The purchase order is prepared by filling out a standard form, an example of which is shown herein.

A number of copies of the purchase order may be prepared and disposed as follows: The original is sent to the vendor of the goods ordered; one carbon copy is sent to the receiving clerk for checking the purchase when received; another is sent to the stores clerk or other person who originated the purchase through his requisition; a third carbon copy goes to the accounting or auditing department, where it will be used in verifying the purchase invoice when it is received from the vendor; and a fourth carbon copy is kept by the purchasing department in its files.

Ben Sheff Paint Co.
DEALERS IN MATERIALS AND SUPPLIES
FOR THE PAINTER AND PAPER HANGER
2031 BROOKLYN AVENUE
ANgelus 7731 - Los Angeles

PURCHASE ORDER

SHOW THIS NO. 1157
ON ALL INVOICES, DELIVERY SLIPS, CASES, PACKAGES, ETC.

__________ 19 __

To

Gentlemen: Being governed by instructions hereon, please enter our order for the following:

Ship When	*Via*	*Terms*	*Confirming*

QUANTITY WANTED	NUMBER	DESCRIPTION	PRICE	PER	AMOUNT

Orders to be effective must be made out on this form and must have the signature of the Purchasing Agent.

Ben Sheff Paint Co.

BY __________
PURCHASING AGENT

REG. U. S. PAT. OFF.

Purchase Order Form

Content of Purchase Order.—A well-constructed purchase order includes the following:

1. Name of the vendor to whom the order is sent.
2. A description of the goods ordered.
3. Quantity and units of goods ordered.
4. Price to be paid for the goods or materials, including terms of payment, etc.
5. When delivery is to be made.
6. Shipping directions.
7. Any special identification marks for packages, such as the purchase order number.
8. Any special conditions or references not written out in detail in the order.
9. The signature of the purchasing agent representing the company.

A purchase order, when received and accepted by the vendor, becomes a contract of purchase. This is the usual form of purchase contract. Purchase contracts are also drawn in blanket form, usually covering a large quantity of raw materials or supplies for which no definite delivery dates are scheduled, or if scheduled, extending over a considerable period of time and more or less subject to special conditions arising from time to time. A blanket contract is placed with a vendor only after careful survey of all data available and final approval by the manager.

Acceptance or Acknowledgment Card.—This is a card or printed form which is sent to the seller along with the purchase order, to be returned by him with his signature when he accepts the order. The purpose of the card is to bind the seller legally in writing to make delivery in accordance with the terms of the purchase order. If such acceptance card is not used, the seller may be requested to acknowledge his acceptance of the order by letter.

Verifying Seller's Invoice.—When the receiving clerk has completed his inspection and count of a shipment, a carbon copy of his receiving report, showing the actual quantities received, is sent to the purchasing department where the quantities thus shown are compared with those on the vendor's invoice as well as those on a complete copy of the purchase order. When the shipment and the invoice are thus checked against each other and against a copy of the purchase order, the invoice is routed to the accounting department where a clerk checks the extensions and footings before the invoice is authorized for vouchering and entry in the purchase journal or voucher register. A carbon copy of receiving report is sent with the goods received to the storeroom, where the stores clerk makes entries upon the inventory sheets or materials ledger after checking the quantities.

CHECKING PURCHASE SHIPMENTS ON RECEIPT

Approved Method of Checking Incoming Shipments—Verifying Shipments Against Invoices and Purchase Orders

Receiving Clerk or Department.—The receiving clerk or receiving department is responsible for counting and checking all purchase shipments received. All incoming shipments are first routed to this department, where they are opened and inspected in order to see that the shipments are as ordered. This checking is made against a carbon copy of the purchase order which was routed to the receiving department when the original copy was mailed to the vendor of the articles ordered. While a complete copy of the purchase order may be furnished the receiving department for this purpose, showing the quantities of each of the articles, it is considered better practice to prepare it with a short carbon sheet so that the quantities ordered will not be typed on it. This assures more careful count on the part of the receiving department than when the copy of the purchase gives them what they should expect in the shipment. This copy without quantities indicated is called a "blind receiving report."

HANDLING OF PURCHASE INVOICES

Invoices as Handled in Small and Large Businesses—Manner of Indicating Accounts to be Debited with Purchases

Audit of Invoices in a Small Business.—The purchase invoice representing an incoming shipment of merchandise should be received in the accounting department, where it should be verified and audited. In a small business, if the invoice is received before arrival of the goods, it is usually held till their arrival and then checked against them as to quantities, quality, and price. The extensions and total are verified and entry made in the purchase journal, using the audited invoice as a basis. The invoice is then placed in a temporary unpaid invoice file till paid, after which it is usually filed alphabetically in a paid invoice file under the vendor's name for future reference. The check in payment of the invoice, when returned canceled by the bank, is sometimes attached to the invoice for which it was issued as evidence of its settlement. The paid invoice should bear on its face a notation to show the payment, if the canceled checks are filed separate from the invoice.

Audit of Invoices in a Large Business.—In a large business where the clerical work is divided among several departments, the procedure of auditing purchase invoices is more complex. Several copies of the original purchase order sent to the vendor are usually made out—one copy, for instance, for the purchasing department, one for the receiving room, one for the auditing department, and so on. The copy furnished the receiving room, for checking the shipment when received, is usually left blank as to quantities. When the goods are received, the copy of the purchase order is filled out, and sent to the auditing department where it is checked against the auditor's copy of the order and the purchase invoice from the vendor. If found correct as to quantity, kinds of goods, extensions, and additions, the invoice becomes the basis for entry in the purchase journal if that journal is used, or for vouchering and entry in the voucher register if that system is used, after which it follows the customary routine as to filing. The invoice remains in a temporary file as long as it is unpaid. Upon payment it is placed in a permanent file, either under the name of the vendor, by invoice number, or according to whatever system may be in use.

Invoice Stamp for Insertion of Audit Data.—In many establishments, when the purchase invoice is received in the accounting department, it is immediately imprinted on the back with a large rubber stamp, called "invoice stamp," for the insertion of audit data. The spaces provide for the signatures of the one who verifies the extensions and footing, and the one who checks the accuracy of the prices, terms, and discounts. Space is also provided to indicate the accounts to be charged by the entries made in the purchase journal or voucher register. The distribution of these charges is usually authorized by the signature of the controller or the accounting or operating officer. Below is shown

Audit	Data
Puchase Order No.	Price O.K
Rec'g Slip No.	Terms Net 2% 10th
Amt. Frt. or Exp. Our Cost Their Cost	F.O.B. at P.O. Dest.
Frt. Chgd on D.M. No.	Chg. Acct. No.
Quantity O.K Errors Chgd. D.M. No.	Extension O.K. O.K for Payment
A/C. Pay Inv. Entered	A/C Pay. App. Posted

Stamp Used in Auditing Invoices

such a stamp. Before the stamped invoice is filed away, a copy of the purchase order and receiving report may be attached to it so as to have the complete set of original records together in one place. Instead of being stamped, the invoice itself may contain a form of the insertion of audit data by the customer, as shown in the form on the following page.

Invoice Checking Department.—In large organizations handling many incoming invoices, a separate invoice checking department is maintained, to which all invoices, expense bills, purchase orders, and receiving reports are forwarded

ADDING MACHINE COMPANY

NEW YORK, N. Y.

Refer to Invoice Number 39871

FOR CUSTOMER'S USE ONLY

Register No.	Voucher No.
F. O. B. Checked	
Terms Approved	Price Approved
Calculations Checked	
Transportation ______ Freight Bill No. ______ Amount	
Material Received ____ 19 ____ Date ______ Signature ______ Title	
Satisfactory and Approved	
Adjustments	
Accounting Distribution	
Audited	Final Approval

Customers Order No. & Date 6139
Requisition No.
Contract No.

Invoice Date 1/4/19--
Vendor's Nos.

The Gerald Press Co.
1015 East 26th St.
New York City

Shipped to & Destination
Date Shipped
Car Initials & No.
How Shipped and Route Truck
Terms Net: no discount

From
F. O. B.
Prepaid or Collect
Salesman 101 M

QUANTITY	DESCRIPTION	UNIT PRICE	AMOUNT
25 rolls	B B S C Paper	.33	8.25
	Sales tax		.08
			8.33

DUPLICATE

Please make all checks payable to .... Adding Machine Company

Invoice Containing Form for Insertion of Audit Data by Customer so that they may be audited together. The only accounting record necessary in this department is an invoice register (see page 136).

PURCHASE INVOICE MATURITY TICKLER

Various Methods of Keeping Record of Unpaid Invoices—Use of Invoice Register

This is a memorandum record of invoices showing on what dates the invoices must be paid in order that cash discounts may be taken. Various methods are used in keeping this record. One method is to prepare the memorandum as a carbon copy of the invoice registration. Another is to make the regular invoice register in duplicate, filing one copy chronologically by the first discount date shown thereon. When the payments for that date are taken care of, this copy of the invoice register is then moved forward to the next maturity date. In this way each sheet of the invoice register becomes a traveling tickler, turning up the payments for each particular discount date to which it has been assigned. Another method is to insert a card at the time of making entry in the invoice register, noting thereon the date that the particular invoice is discountable. This card is filed by discount date. Still another method is simply to maintain a "discount date register" or "maturity tickler" for each payment date, upon which are entered all invoices that are due and discountable on that date.

INVOICE REGISTER

Function and Form of the Register—Extent to Which Registration of Invoices Is Carried

It is good practice where many purchase invoices are received, to register them immediately upon receipt and before time is taken for verifying and vouchering them so as to authorize the formal entry of their amounts on the books. The registry is done in a special journal called an invoice register, or invoice journal. This is usually a columnar loose-leaf book with a line for each invoice. Invoices are numbered in sequence by stamping them, and the number is entered in the invoice register, unless the lines of the register are already numbered. Registration of invoices varies in

NO. RECORD OF INVOICES AND VOUCHERS MONTH OF 19

DATE OF ENTRY	DATE OF INVOICE	INVOICE NUMBER	ACCOUNTS PAYABLE CREDIT	√	DESCRIPTION	GENERAL LEDGER		√	DATE PAID
						ACCOUNT	DEBIT		
					AMOUNTS FORWARDED				

Invoice Register

extent from the date of the invoice, the vendor's name, and the amount of the invoice, to a much wider registration which may also show the accounts to which the particular invoice is to be charged. One form of invoice register is shown herein. As soon as an invoice is audited and vouchered, its record is complete so far as the invoice register is concerned.

THE PURCHASES ACCOUNT

Use of the Account in Merchandising Business—Handling of Purchase Returns and Allowances

"Purchase" Defined.—In a broad sense everything a merchant buys may be called a "purchase." He must buy his store equipment, his delivery equipment, the services of his salesmen and clerks, etc. In some businesses whatever is bought, whether stock-in-trade, real estate, machinery, furniture and fixtures, services of all sorts, purchase of insurance, is spoken of broadly as a "purchase" or a "purchase transaction." Ordinarily, however, and particularly in merchandising concerns, the term "purchase" is restricted to purchases of merchandise for sale. The Purchases account on the general ledger is used to record by debit entry at their invoice cost, merchandise purchases made during the current fiscal year. It represents the year's gross addition to the merchandise inventory. It is debited monthly for the total purchases made, the posting being made from the purchase journal. At the close of the year, the balance of the account is transferred to the Cost of Goods Sold account by way of arriving at the cost of the goods sold during the year, or directly to the Profit and Loss account.

While returned purchases, and purchase rebates and allowances, may be entered on the credit side of the account as offsets to or deductions from the gross amount of purchases, it is customary to make these credit entries in one or two separate accounts; but in any event, the net purchases for the year are found by deducting from the gross purchases, as shown on the debit side of the Purchases account, the total of the purchase returns, rebates and allowances, as shown on the credit side of the Purchases account or in separate account or accounts.

When Purchases Account Is Used.—This method of recording additions for the year to merchandise inventory is employed by the ordinary merchandising concern which relies solely upon the periodic physical inventory for determining profits and the value of the merchandise in stock at the close of the accounting period. Where, however, the perpetual inventory method is used, that is to say, where running records of purchases and withdrawals of individual items making up the total inventory are kept, the debits and credits are made directly to the respective accounts on the subsidiary ledger or ledgers and one or more controlling inventory accounts on the general ledger. No separate Purchases account is then maintained.

THE SINGLE MERCHANDISE ACCOUNT

Mixed Character of the Account—Why It Does Not Serve Purpose of Modern Accounting

Entries Made in the Account.—Originally the record of all merchandise transactions was kept in one account, Merchandise; and even today in some small businesses this single merchandise account may be found. When so used the account is merely a combination of a number of separate accounts. The entries which are made on both debit and credit sides of the account are as follows:

Merchandise Account

Debit Entries	*Credit Entries*
Merchandise Inventory (at cost)	Merchandise Sales (at sales price)
Merchandise Purchases (at cost)	Returned Purchases (at cost)
Inward Freight and Drayage	Purchase Rebates and Allowances
Returned Sales (at sales price)	
Sales Rebates and Allowances	

Mixed Character of the Account.—The single merchandise account is a mixed account, due to the fact that the price at which sales are entered includes profit in the sales transactions as well as cost of merchandise. It is, therefore, necessary at the close of the fiscal period, to separate the account into its basic elements. However, the chief objection to the use of this single merchandise account is the difficulty of securing from it easily and quickly the different kinds of information needed in the management of the merchandising activities. Under modern practice of accounting for merchandise, each class of entries made in the single merchandise account, as given above, is carried in a separate account. There is one account for Merchandise Inventory, another for Purchases, and a third for Sales. Returned purchases, and purchase rebates and allowances, being both offsets to purchases, may be carried together in one separate account, while returned sales and sales rebates and allowances, being offsets to sales, may also be carried together in a single account, or they may be entered in the Sales account.

SIMPLE PURCHASE JOURNAL

Form of Journal—Purchases Entered in Journal—Posting and Closing—Loose-leaf Journal

Form of Simple Purchase Journal.—The purchase journal in its simplest form is used for recording purchases of stock-in-trade by a mercantile or trading business. Each individual purchase is entered on a separate line of the journal, which is divided into columns to show the date of the entry, the vendor from whom the purchase was made, the terms of purchase, the ledger folio, and the amount of the purchase. Additional columns may be provided for keeping a record of the purchases distributed into certain classes, such as

Purchase Journal

Date 19–		Purchased of	Terms	F	Cr. Creditor		Dr. Purchases	
Jan.	3	B. Peterson & Company	Cash	√	$1,875	00		
	5	B. Peterson & Company	n/30	√	1,470	00		
	17	Henry Holmes	n/30	√	130	00		
		R. Yeomans	n/30	√	718	75		
		B. Peterson & Company	n/10	√	165	00		
	26	Western Milling Company	n/10	√	2,200	00		
	31	Purchases Dr.		76			$6,558	75

(a) Typical Purchase Journal for Trading Concern

those made for the several departments of the store. Form (a) presents a typical purchase journal for the trading concern.

In one form of purchase journal—see form (b)—all references to the articles purchased is omitted, columns being provided only for the name of the creditor, his address, and the terms of the purchase. This condenses the record and results in a considerable saving of time. If information is desired concerning the particulars of a purchase transaction, reference need only be made to the invoice. To facilitate such reference, the purchase invoices are numbered consecutively and these numbers are entered in the special column provided for the purpose in the form of purchase journal shown in (b).

The invoices themselves are filed numerically or alphabetically.

Purchase Journal

Date		Inv. No.	Name	Address	Terms	F	Amount
19— Feb.	1	1	Johnson Brown Co.	Flint, Mich.	2/10 n/30	22	11000 —
	1	2	Brackett & Hough	Chicago, Ill.	n/60	23	1000 —
	3	3	The Big 4 Truck Co.	Detroit, Mich.	n/10	24	11000 —
	29	4	The Locomotive Co.	Phila., Pa.	2/10 n/30	25	11500 —
	29		Mdse. Purchases, Dr.			14	34500 —

(b) Purchase Journal

Posting the Purchase Journal.—Each entry in the purchase journal is made from the purchase invoice after the latter has been audited and verified as to prices, extensions, terms, etc. In posting this journal, it is customary to post daily the credits to the various vendor accounts as they are entered from day to day in the journal. In this way the true status of the amounts due those creditors may be known at any time by reference to the ledger accounts. The offsetting debit to Purchases account is posted only at the end of the month, when the purchase journal is summarized, that is, the dollar amount column is footed, and a debit entry for the total is passed to Purchases, which must always be made before the trial balance is taken. The purchase journal is then ruled off as shown in form (a) and thus made ready for new entries for the next month immediately below the rulings. It will be noticed that in this form of purchase journal a separate column is provided for the summary debit entry at the close of the month. This, however, is not absolutely necessary, as the entry may be made in the manner shown in form (b).

Cross-indexing of Journal and Ledger.—In some cases, particularly where a bound ledger is used, it is necessary to cross-index the two records—the journal and the ledger—by inserting the page number of each record in the respective folio column of the other record. However, the folio column of the purchase journal may be used simply to receive a check mark against each entry as it is posted to the ledger as shown in form (a). This will be necessary, for example, where the ledger is a loose-leaf volume and new pages for newly opened accounts with creditors are inserted in various places in the volume. The accounts may be arranged alphabetically, according to the names of the creditors and can be readily found without the aid of any reference in the journal to the number of the particular ledger page.

Recording Purchases of Supplies.—As already stated, in the trading concern only purchases of stock-in-trade are entered in the purchase journal. It is not customary to make a record of the numerous small purchases of supplies of various sorts upon their receipt, entry being held over until these items are paid for. In this way the first record of these transactions is made in the cash disbursements journal.

DEPARTMENTAL PURCHASE JOURNAL

Additional Columns Required in Journal—Making the Summary Entry on the Journal—Posting of Journal

Form of Departmental Purchase Journal.—When it is desired to separate various classes of purchases so as to determine the profit from each class, particularly in a business which is departmentalized, a purchase journal may be used similar to the one shown below, which has an additional money column for each class of purchases. If there are three classes or departments, at least four money columns are required. The entry in the first column is for the total amount of the purchases; and the entries in the other three columns, which are headed each with the name of a class or department, are for the distribution from the total column of purchases made for the respective departments. The totals of these three columns, added together, must at all times be equal to the total of the first column. This affords a check on the accuracy of

DATE 19—		NAME	INV. NO.	TERMS	L.F.	TOTAL		DRUGS		STATIONERY		CANDIES	
Nov.	1	A. B. Colving & Co.	75	1/5, n/30	67	3,000	—	2,000	—			1,000	—
	5	Daines Bros.	76	2/10, n/30	70	1,250	—	300	—	850	—	100	—
	30	Purchases, Dr.				10,125	40	4,269	80	3,197	25	2,658	35
								(94)		(95)		(96)	

Departmental Purchase Journal

the distribution. At posting time a separate account is opened in the ledger corresponding to each of these of purchases. The summary entry in a purchase journal of this kind appears as shown in the illustration.

Summary Entry.—Note how the summary entry is made. In this case there are three purchase accounts in the ledger, namely: Purchases Drugs, Purchases Stationery, and Purchases Candies. To each of these is posted the total of its column in the purchase journal. These three debits offset the individual credits posted throughout the month to the individual creditors' accounts in the ledger. The grand total, or \$10,125.40, is not posted. Note how the cross-indexing of the postings is shown, these several Purchase accounts appearing, as indicated, on pages 94, 95, and 96 of the ledger.

Where the number of departments is small, the summary entry may be stated in full in the total column as follows, with the cross-indexing shown in the regular folio column:

Purchases, Drugs, Dr.			94	4,269	80
Purchases, Stationery, Dr.			95	3,197	25
Purchases, Candies, Dr.			96	2,658	35
				10,125	40

RETURNED PURCHASES AND ALLOWANCES

When Entry for Returns and Allowances Is in Order—How Return Shipment of Purchases Is Controlled

Entries for Returned Purchases and Allowances.—When goods purchased prove unsatisfactory upon receipt and are returned to the vendor, or a claim is filed with the vendor for a rebate or allowance from the invoice price if the goods are retained, the entry for the return or allowance is charged to the vendor's account, and a credit to Purchase Returns or to Purchase Rebates and Allowances account, as the case may be, is made. These two latter accounts, however, are often merged into one account, called Purchase Returns and Allowances. The entry should not be made, however, until a credit memorandum or a letter has been received from the creditor accepting the return of the goods or making the allowance. Since the balance of the Purchase Returns and Allowances account is really an offset to the Purchases account, it may be transferred when closing the books to the Purchases account, or as is frequently done, it may be transferred directly to the Profit and Loss account.

Purchase Returns and Allowances Journal.—Unless a special journal is used to record such returns and allowances, the posting to the account is made from the general journal. If the number of such transactions is sufficient to justify it, a special journal should be used to record them—see form (a). In that case only the debit element of each return allowance is entered currently. At the close of the month, the journal is summarized, in the same manner as the purchase journal, and a credit is passed for the total returns and allowances for the month to the Purchase Returns and Allowances account. The form of this journal is similar to that of the purchase journal and will carry similar distributive columns if the purchase journal does. Another form of a returned purchases and allowances journal is shown in form (b). Note the reference to the vendor's credit memorandum or letter in the explanation column.

Purchase Returns and Allowances Journal

Date		Pur. No.	Name	Address	Terms	Remarks	F	Amt.	
19—									
Mar.	4	29	Eastern Hat Co.	156 Greene St.	3/10, n/30	Broken frames	26	136	75
	10	42	Silk Web Hat Co.	213 Greene St.	2/5, n/30	Ribbons wet	71	79	85
	15	48	N. Y. Leather Co.	25 West 3d St.	2/10, n/30	Bands cut short	47	56	—
	21	53	U. S. Hat Dye Co.	121 Greene St.	1/15, n/60	Wrong colors	80	35	26
	28	57	Peck Fur Co.	37 West 4th St.	2/5, n/30	Quality bad	64	125	49
								433	35
	31		Accounts Payable	$433.35			10		
			Purchase Returns and Allowances			$433.35	19		

(a) Purchase Returns and Allowances Journal

Date		L.F.	Name	Explanation	Amount	
19—						
Jan.	8	√	Green & Co.	Their credit memo 42	200	–
	10	√	L. D. Smith	√ letter Dec. 10	400	–
					600	–

(b) Returned Purchases and Allowances Book

Authority for Purchase Returns Entry.—Purchases should be returned through the shipping and not the receiving department. The paper work required in order to give authority to make the return shipment and make the necessary book entries may be as follows: A returned purchase slip is made out in triplicate in the receiving department, where

RETURNED MATERIAL DEBIT
FROM
THE A. B. C. CO.
CHICAGO

Charge to____________ Date Returned____________

Address____________ Date Charged____________

WEIGHT	SYMBOL	QUANTITY	DESCRIPTION	PRICE	AMOUNT

This is an order to perform the service indicated below

Shipped — Shipping Charges

Via Freight______ Prepaid______

Express______ Collect______

Total Debit

IMPORTANT—This R.M.D. has been charged against you

If material is to be corrected and returned, ISSUE NEW INVOICES as shipments are made, and show R.M.D. Number thereon.

This number must appear on all invoices, packing slips and packages

A. B. C. CO.

RMD A 7280 A

(An unpriced copy of this R.M.D. is packed with returned material)

Returned Purchases Debit Memorandum

the decision to return the goods is made. All copies go to the shipping clerk, which is his authority to make the shipment. The original is sent to the vendor with the goods as a packing slip, the second to the billing clerk, while the third is retained by the shipping clerk. The billing clerk thereupon prepares in triplicate a returned purchases debit memorandum, similar to that shown in the form herein. The first copy is mailed to the vendor; the second copy is sent to the voucher clerk, if the voucher system is in use, and if the voucher is unpaid, the invoice value of the returned goods is deducted. The third copy goes to the general ledger bookkeeper for debit to the Vouchers or Accounts Payable account and credit to Returned Purchases account. Instead of a separate return purchase slip, extra copies of the debit memorandum or form may be used.

ACCOUNTS PAYABLE LEDGER

Operation of a Loose-Leaf Ledger—Entries Posted to Creditors' Accounts—Showing Currently Balance of Each Account

Bound and Loose-leaf Ledger.—The accounts payable ledger contains the accounts with trade creditors, who have sold the firm merchandise. Such a separate record will only be maintained when the accounts are fairly numerous. It may be a bound volume, but it is usually a loose-leaf ledger. In this form it is better adapted for dropping old accounts and opening new ones, and at the same time maintaining an alphabetical arrangement of the accounts. Any account can be found through the index in the front part of the ledger and referred to at once without consulting the purchase journal for the ledger folio on which the account appears. The pages of this loose-leaf ledger are not numbered, and instead of entering the ledger folio in L.F. column of the purchase journal or the cash disbursement journal, as is necessary when a bound volume with numbered pages is used for the ledger, the bookkeeper merely enters a check-mark as he posts each item to show that he has made the posting.

Posting Creditor's Account.—The postings to the accounts payable ledger consist of credit entries made from the purchase journal, to show the amounts owed to the respective creditors for purchases, and debit entries made from the cash disbursements journal, to show the amounts of the account paid. If a purchase has been returned or a creditor has made an allowance on a purchase because of the goods being of a lower quality than those ordered, or for any other reason, the account is debited for such returns and allowances, either from the general journal or from the special purchase returns and allowances journal, if one is used.

With each posting the clerk in charge of the accounts payable ledger enters in the folio column of the ledger the initials and page of the journal from which he has made his posting. Thus, if the posting has been from page 5 of the purchase journal, the cross-reference to this page entered in the folio column of the accounts payable ledger will be "P 5"; if from page 8 of the cash disbursements journal, it will be "C D 8"; if from page 3 of the purchase returns journal, it will be "P R 3"; if from page 7 of the general journal, it will be "J 7." This is shown in form (a) below, which gives a creditor's account in simple form. The balance in the account is usually indicated in small pencil figures, whenever an abstract or listing of the account is to be prepared.

Removal of Old Account Sheets.—Periodically sheets of accounts no longer active, all items of which have been paid, or the filled sheets of active accounts, all items of which have been paid, are removed from the ledger binder and transferred to another binder called transfer ledger in binder, where the sheets remain for an indefinite time until all possible occasion for their use has passed.

Form of Accounts Payable Ledger.—An account payable or creditor's account is headed with the name of the creditor and sometimes also with his address, though it may be safer to depend upon invoices for the current address rather than the account itself. The account is ruled in a variety of ways, all of which are more or less standard. Form (a) is the ordinary account form, having a separate debit and credit section, each with columns for the date, explanation, folio, and amount.

L. H. Smith Company

Date		Explanation	F	Debit		Date		Explanation	F	Credit	
19—						19—					
Jan.	10		RP1	a200	–	Jan.	2	400.00	P1	a1,000	–
	20		CD1	a400	–						

(a) Account Payable

Form (b) has the same ruling, with these additional features: a √ column in addition to the journal folio column, called "Posting Reference" in the form, and an additional column in order to show the balance of the account after each entry.

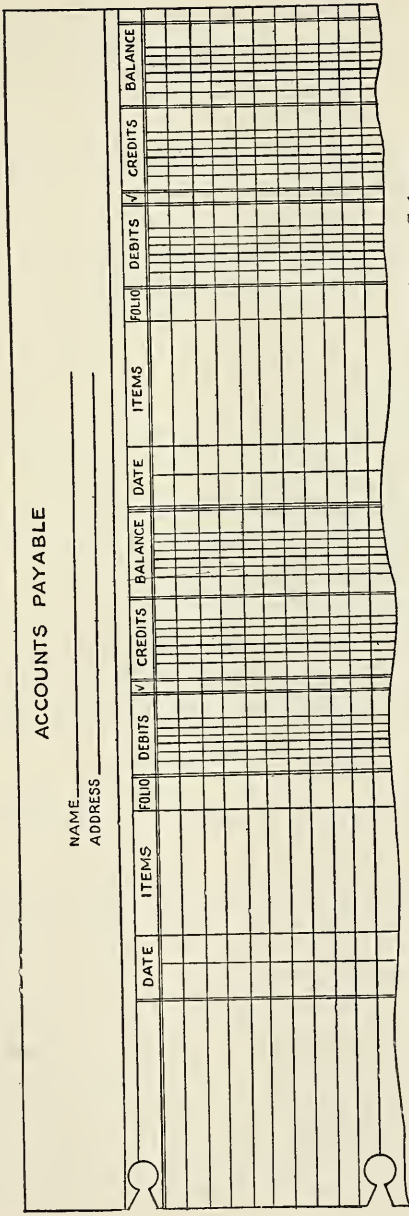
Form (c) has the debit, credit and balance columns adjoining each other. It is generally called the "Boston Ledger" type and is easily adapted to use on bookkeeping posting machines.

NAME

ADDRESS

DATE 19__		POSTING REFERENCE	√	CHARGES	DATE 19__		POSTING REFERENCE	√	CREDITS	DR OR CR	BALANCE

(b) Standard Ledger Sheet for Accounts Payable



(c) Form of Accounts Payable Ledger with Adjoining Debit, Credit, and Balance Columns

FREIGHT ON PURCHASES

Treatment as Part of Cost of Purchases—When Handled as an Operating Expense

Freight on goods purchased, when the buyer pays it, is called freight-in. Such payments may be charged to a separate account called Freight-In, or directly to the Purchases account. This class of expenditure is really a part of the cost of purchases, and in preparing the profit and loss statement at the end of the period, the balance of the Freight-In account, when a separate account is used, should be shown as an addition to purchases.

In certain cases, when the purchases are large, and the amount of freight on each separate purchase is available, it may be desirable to add in the case of each purchase the freight to the invoice price, and charge the total directly to Purchases. This will eliminate the need of a Freight-In account.

Where freight costs are of a very small amount, they are sometimes treated as an operating expense, and the balance of the Freight-In account is transferred to the Profit and Loss account, when the books are closed.

PAYMENT OF FREIGHT ON SHIPMENTS

Various Arrangements Made with Seller to Pay Freight—Correct Basis for Computing Cash Discount

Freight Paid by Purchaser.—When merchandise is shipped f.o.b. destination, the terms of sale are that delivery of the goods be effected at the purchaser's location. Under such arrangement the seller undertakes to pay all transportation charges, and he carries the risk of the loss of goods when in the carrier's possession. If the loss occurs, it falls to him to file a claim with the transportation company. Occasionally, however, the seller requests the purchaser to pay the freight and deduct the amount from his remittance. In that event the deduction is made after the subtraction of the cash discount and not before, as the cash discount should be based on the invoice price, and not the invoice price less the freight, thus:

Invoice	$200.00
Less cash discount—2%	4.00
Balance	$196.00
Freight—paid for seller	10.00
Amount of remittance	$186.00

Freight Paid by Seller.—Where merchandise is sold f.o.b. shipping point, the purchaser takes possession of the goods at that point. Under such delivery he pays the transportation cost and takes the risk of loss or damage to the goods while in transit. At times, however, the seller will prepay the freight and add the amount to the invoice. In making his remittance the purchaser should take the cash discount on the cost of the merchandise only, thus:

Invoice	$200.00
Less cash discount—2%	4.00
Balance	$196.00
Freight—paid by seller	10.00
Total remittance	$206.00

VOUCHER REGISTER

"Purchases" as Used in Connection with Register—Operation of the Voucher System—Distributive Columns in Voucher Register

Voucher Register Contrasted with Ordinary Purchase Journal.—A "voucher register"—also referred to at times as "voucher record," or "record of audited vouchers"—is a purchase journal expanded and modified so as to serve certain larger purposes, particularly in a manufacturing concern. The ordinary purchase journal is used primarily to record stock-in-trade purchases. For example, it is not customary to make a record in the purchase journal of the numerous small purchases of supplies. Upon the receipt of the supplies and approval of the invoice, no entry is made until the invoice is to be paid. The first record of these transactions, therefore, is made in the cash disbursements journal. Nor is any entry made for services received or labor performed until payment is actually made. This method of accounting may be satisfactory for a small trading concern, but in a manufacturing business with a larger plant investment, a greater labor force than in the mercantile establishment, and with the use of general cost accounting system, information concerning various types of expenditures must be furnished executives expeditiously. It is necessary, therefore, to record not only purchases of stock-in-trade, but also purchases of operating supplies, labor, and services of all kinds, as soon as the liability for such supplies and services is incurred and not merely when the payment for them is made. In other words, the term "purchases" as used in connection with the voucher register is broadened to include all liabilities as incurred, on whatever account. A second fundamental characteristic of the voucher register is that by its use the creditors subsidiary ledger is completely or partially done away with.

Form of the Register.—Numerous voucher register forms are used, each adapted to the particular purposes sought by the organization, but the comparatively simple one shown herein will serve to illustrate the general method of operating the voucher register. The entry for each "purchase," of whatever nature, is made on a separate line, as soon as the liability for it is incurred, whether the liability is for the purchase of materials, supplies, or for services or labor received and performed. The date column shows the date of entry,

VOUCHER REGISTER

DATE 19—		VOUCHER NO.	CREDITOR	EXPLANATION Terms, etc.	PAYMENT Date	PAYMENT Manner	VOUCHERS PAYABLE	PURCHASE DISCOUNT	RAW MATERIALS	IN-FREIGHT CARTAGE	
May	1	2,369	Thomas Byrne	net	May 10	C 36	4,000 —				
	2	2,370	Arthur French	2/10, 1/30, n/60	May 11	C 37	380 —	6 88	343 80	36 70	
	3	2,371	Leff & Co	2/15, n/30	May 18	N.J. 10	425 30	8 51			
	5	2,372	Truston Jones	1/10, n/30	May 15	C 38	1,919 40	17 99	1,470 —	120 60	
	7	2,373	Harvey Hubbell Inc.	2/10, n/30			1,251 60	25 03			
	8	2,374	Payroll		May 8	C 34	2,798 67				
							10,774 97	58 41	1,813 80	156 80	
							L54	✓	L60	L61	

VOUCHER REGISTER

	DIRECT LABOR	INDIRECT LABOR	FACTORY EXPENSE	SALES SALARIES	SELLING EXPENSE	OFFICE SALARIES	OFFICE EXPENSE	SUNDRY CHARGES	L. F	ACCOUNT TO BE CHARGED
								4,000 —	24	Delivery Equipment
			276 70		149 10					
			200 —		128 80					
							51 60	1,200 —	19	Furniture & Fixtures
	1,820 40	632 17		241 60		104 50				
	1,820 40	632 17	476 20	241 60	277 90	104 50	51 60	5,200 —		
	L62	L63	L64	L70	L71	L80	L81	✓		

Voucher Register (*left and right pages*) while the voucher column sets forth number of the voucher for which the entry was made. The voucher is simply a standard form on which is made a transcription of the purchase invoice with additional data for the guidance of the bookkeeper in charge of the voucher register. (See page 156.) Before a voucher can be entered it must be approved by the signature of a responsible individual. When the so-called "purchase" represents accrued payroll, or some similar liability for services or labor received, for which the company will not receive an invoice, a voucher is nevertheless made for such expenditure as it may be called, since one of the cardinal principles of the voucher system is that no entry may be made unless the transaction is vouchered, that is to say, authorized by a properly executed voucher form.

Vouchers Payable Column.—The creditor column in the voucher register contains the name of the vendor, if the transaction consisted of a purchase of materials or supplies, or "Payroll" if the item on account of which the liability has been made refers to labor services. However, no individual accounts need be carried on the ledger to show the amounts due each individual creditor. The unpaid vouchers take the place of the creditors ledger. Detailed postings as in the case of the purchase journal would require the opening of numerous creditor accounts, in many of which there would be one or at the most a very few entries. This is true particularly in the case of supplies and services, which are not purchased very often nor from the same vendors. Instead, there is only one general credit entry made at the close of the month to a controlling account on the general ledger, Accounts Payable or Vouchers Payable, for the total of the purchases, as the term is used in its broader sense, for the period as shown by the Vouchers Payable column.

The voucher register by this method not only serves as an expanded purchase journal but also functions as a check on the subsidiary creditors ledger (unpaid vouchers file), except that the entries for purchases made from a particular vendor are not grouped together in one account, but appear on separate lines in chronological order. In the Explanation column are recorded the terms of the purchase. When payment is made, that fact is recorded in the Payment columns, by entering the date as well as the number of the check as shown on the check register. If payment is by a promissory note, a reference to the page of the note journal in which the note has been entered will be made, as shown in the third line of the voucher register given.

The Purchase Discount column is a credit column if the credit entry in Vouchers Payable column is made at the net amount in anticipation of taking advantage of the discount. Otherwise, it is simply a memorandum column. (See Purchase Discounts under Voucher System, page 97.)

Distribution Columns of Voucher Register.—The remainder of the voucher register is taken up with distribution columns showing the debit entry or entries to be made in connection with each transaction. It is in these columns that the voucher register shows its greatest variation and flexibility. The number of these columns will depend upon the organization's classification of accounts, and as the voucher register is an indispensable adjunct of any practical cost accounting system, columns will ordinarily be found for the general and expense ledger controlling accounts, for the cost records, such as raw materials, direct labor, and factory expense. There will also be columns for various outlays made by the sales department, and for office expenses. The voucher from which the clerk in charge of the voucher register makes his entries will indicate the columns in which entry is to be made.

These distributive columns in a manufacturing business are usually arranged in sections, one section composed of a number of columns for manufacturing accounts, another section of columns for various selling expense accounts, another for general administrative columns, followed by several miscellaneous columns. The postings from these columns are made at the close of the month, as in the case of the purchase journal, when the columns are footed and the accounts on the general ledger are debited with the respective totals. The page of the ledger on which the account is found is entered underneath the total of the column. Separate columns are provided for frequent expenditures of a particular class. To take care of the infrequent expenditures a separate section for sundry items is added. This consists of three columns—one for the amount, and another for ledger folio, and a third for the name of the account. The debit postings for these miscellaneous transactions are made individually to their respective accounts at the close of the month, or one summary entry is made to each account for the total of the items in the sundry column properly chargeable to it.

THE (DISBURSEMENT) VOUCHER

Voucher as Basis for Making Payment and Making Entry—Debit and Credit Analysis in the Voucher—Several Files for Keeping Vouchers

Purpose of Voucher.—In connection with the voucher register the voucher plays more or less the same rôle as the purchase invoice (which it supplants) when the simple purchase journal is used. When properly filled out, audited and signed, it constitutes the cashier's authorization to draw a check in payment of the invoice. This check is then ready for the signature of the treasurer. The voucher is also the bookkeeper's authorization to enter the purchase in the voucher register, and at the same time gives him specific directions relative to the manner in which the invoice amount is to be distributed in the debit columns of the register.

Voucher No.______
Check No.______

THE NATIONAL MANUFACTURING CO.

To (Name of Creditor) ______ Dr.
(Address)

Terms:

(Details of items Covered by Voucher)

Approved: (Purchasing Dept.)
Approved: (Auditor)

Passed for payment (General Manager)

(Place & Date) 19____

Received ______ Dollars $______
In full settlement of above items

Signed (Creditor)

PLEASE RECEIPT AND RETURN

(face)

(Name of Creditor) No.______
(Address)

THE NATIONAL MANUFACTURING CO.
Brooklyn N.Y.

VOUCHER

PAID BY CHECK No.______ $______
DATE ______

CHARGE TO		
Total forward		
Office Salaries		
Office Supplies		
Sundry Office Expenses		
Tel. Tel. & Postage		
Rent		
Insurance		
Interest		
Plant		
Equipment		
Furniture & Fixtures		
Total		

CHARGE TO		
In-Freight & Cartage		
Direct Labor		
Indirect Labor, Factory		
Light, Heat & Power		
Raw Materials		
Sundry Factory Expense		
Salesmen's Salaries		
Salesmen's Commissions		
Advertising		
Delivery Expense		
Out-Freight		
Total		

(reverse)

Voucher

Form of Voucher.—The vendor's bills or invoices by which purchases of materials, supplies, or services are evidenced are of various sizes, forms, and colors. To provide a suitable formal document from which to make entry in the voucher register, use is made of what is termed a voucher jacket or simply a voucher, an example of which is given on the opposite page. All vouchers in any particular system are made uniform as to size, color, and form. The essential part of the voucher is an invoice form or ruling which provides space for the name and address of the vendor, the date of the bill, terms, etc., together with details of the items purchased and the amount of the bill. The data on the vendor's bill may be transcribed to the voucher or the invoice may be simply attached to it. These vouchers are numbered as received and will, therefore, follow the chronological sequence of the dates of the relative invoices. The vouchers are entered in this order in the voucher register, the number of each voucher appearing in the column provided for the purpose. The voucher also contains a list of the accounts to which the amount in question is to be debited. This debit and credit analysis or distribution of charges is indicated by an accounting officer or one of the operating officials who has the requisite knowledge as to the proper entries to be made.

Audit of Vouchers.—In the handling of purchases under the voucher method, the same audit or verification is followed as in connection with the purchase invoice for entry in the purchase journal. The vendor's bill when received should be checked against the office copy of the order and also against the goods, supplies, and other items received; unit prices should be checked and verified. Provision is usually made on the voucher to record the initials of the persons who make these various checkings, or a separate check sheet is used, as the one shown below.

CHECK SHEET	Check or Initials	
	Purchasing Department	Audit Clerk
Goods checked to invoice	*J. H.*	
Invoice checked to purchase order: Merchandise O. K.	*L. T.*	
Prices O. K.	*M. S.*	
Discount terms O. K.	*V. S.*	
Freight terms O. K.	*W. S.*	
Extensions and footings checked		*L. R. D.*

Check Sheet

Vouchers are prepared not only for purchases of materials and supplies, but also in connection with the other types of expenditures, labor, and various services. In these cases there are, of course, no vendors' invoices. Nevertheless, every entry in the voucher register must be supported by a properly audited and authenticated voucher.

Voucher Files.—Vouchers may be kept in three groups or files. In the first are the few unaudited vouchers, which have not yet been formally entered in the voucher register for one reason or another. The second group consists of a file of the vouchers, entry of which has been effected on the voucher register, but which have not as yet been paid. This file in connection with the voucher register serves the same purpose as the creditors subsidiary ledger. It is a tickler file in which the audited and unpaid vouchers are kept until the dates fixed for payment, when checks are drawn for the necessary amounts, less any discounts, and remitted to the vendor. The third file consists of all paid vouchers. As these vouchers constitute the explanation and supporting documents for the entries in the voucher register, they should be preserved. They are usually, therefore, arranged in numerical sequence to which reference can be readily made in the event any question should arise concerning any particular invoice.

INSTALLATION OF THE VOUCHER SYSTEM

Transferring Creditors' Accounts to Voucher Register—Change in Name of Controlling Account—Adjustment Necessary to Avoid Duplicating Entry

Preparation of Vouchers.—No formality need attend the installation of a voucher system into a set of books where formerly none was used. The individual accounts in the accounts payable ledger should be closed off by a transfer to the voucher register. In making the transfer to the voucher system, it will be necessary to prepare vouchers, not usually for the balance of each of the creditors' accounts, but for each one of the individual unpaid items in each creditor's account. This is necessary because in accordance with the credit terms extended, each transaction will become due and must therefore be settled at a different due date. If there are, for example, three unpaid items with different due dates in a creditor's account, three separate vouchers should be prepared and entered on the voucher register. A card index of creditors will also be prepared. Usually the control account, Accounts Payable, will have its name changed or will be closed off into a new account termed "Vouchers Payable."

Avoiding Duplication of Credit Entry.—When the individual vouchers are entered in the voucher register, inasmuch as the debit analysis of each of these has already been entered in the records, there will be no distribution to such debit accounts on the face of the register. However, the entry of the amount of these vouchers in the Vouchers Payable column will, when the total of that column is posted, result in a double credit in the Vouchers Payable account—namely, the balance carried over from the Accounts Payable account and an equal amount included in the total of Vouchers Payable column from the voucher register. This must be corrected by securing an offsetting debit of equal amount. The individual vouchers, therefore, are distributed into the Sundry Charges column, and a charge is made to Vouchers Payable account by an entry of that title in the "Account Title" or "Account to be Charged" column. These individual debit postings will exactly offset the double credit to Vouchers Payable indicated above. With these entries made, the system is in balance, and ready for operation.

ACCOUNTS PAYABLE SUBSIDIARY LEDGER UNDER VOUCHER SYSTEM

Additional Column in Voucher Register for Entry of Sums Due Creditors—Handling of Other Expenditures

In some firms it may be desirable to maintain a formal accounts payable subsidiary ledger in which to keep accounts with merchandise creditors in order to secure information as to volume of business done with each, as under the purchase journal method. This can be accomplished through the use of the voucher register by introducing another credit column next to the Vouchers Payable column. (See form below.)

This new column may be headed Accounts Payable or Trade Creditors. In it will be entered only the transactions with those creditors whose accounts are carried in the accounts payable ledger, the total of the column serving as a controlling figure over the credit postings to that ledger. All other trans-

September 1, 19—

VOUCHER NO.	CHECK NO.	ACCOUNTS PAYABLE	VOUCHERS PAYABLE	F		STORE NO. 1	STORE NO. 2	STORE NO. 3	MISCELLANEOUS ACCOUNT	F	
25	48		250 80	✓	The Ozark Company			250 80			
		50 00			Atlas Mfg. Co.		50 00				

Combined Purchase Book and Voucher Register actions will be entered in the Vouchers Payable column. Extension from these two columns into the debit distributive columns is handled in the usual way. By this method accounts need not be kept with the numerous creditors for supplies and expense items, each of them being paid in full for each transaction. Thus the advantages of the voucher system together with the convenience of the accounts payable ledger can be secured through the use of a single special journal, the voucher register.

INDEX OF CREDITORS UNDER VOUCHER SYSTEM

Why Index Necessary—Manner of Conducting—Determining Volume of Business Done with a Customer

Under the voucher system, individual accounts with creditors are usually not kept in a separate creditors ledger, but only on the face of the voucher register. Reference to transactions with particular creditors is therefore difficult, since

VOUCHER INDEX

NAME:

ADDRESS:

Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	
19—													
19—													
19—													

Voucher Index Card

the transactions are not indexed and summarized by creditors' names.

To facilitate such reference, an alphabetically arranged card index of creditors is carried, one card being provided for each creditor. One form of such a card is shown above.

On each card are recorded the various transactions with that creditor. This is in the nature of a posting from the voucher register to the card index. Usually the card index carries only the voucher number. If it becomes necessary to look up transactions with a particular creditor, by reference to this card index a cross-reference to the voucher numbers carrying a record of the transactions with this creditor is obtained. These vouchers can then be drawn out and the required data be made available. The card index also makes possible a determination of the volume of business being done with any creditor—information which is sometimes of importance. By referring to the vouchers covering the transactions with a particular creditor, the total volume of business done can be computed.

HANDLING PURCHASE RETURNS AND ALLOWANCES UNDER VOUCHER SYSTEM

Adjustment Before and After Entry in Voucher Register—When Red Ink Entry Is Made—Adjustment by Entry in General Journal

The Difficulty Encountered.—The handling of purchase returns and allowances, after entry has been made of the original purchase voucher, presents some difficulty under the voucher system. A purchase return or allowance is a debit to the vendor's account, to be deducted from the amount of the original invoice in order to determine the net amount due in settlement of the bill. Under the voucher system, where a single line is given to each account in the voucher register, the debit to the account being simply a memorandum that the account has been paid. and of the manner of its payment, no provision is made for recording adjustments due to purchase returns and allowances.

Adjustment by Red Ink Entry.—If such returns and allowances are made immediately upon the receipt of the goods, the amount can be deducted from the face of the vendor's bill before it is vouchered and passed for payment. The voucher will then carry the net amount after adjustment, and no further problem is encountered. If, however, the amount of the original bill has been entered on the voucher register, the purchase return and allowance must be entered as a deduction item, shown as such by means of red ink, immediately above and on the same line with the entry of the original bill, if the return or allowance is made in the same month in which the original entry in the voucher register was made. If in a subsequent month, the adjustment will be entered separately. The amount of the adjustment will be entered in red ink in the Vouchers Payable column, and will also be extended and entered in the distributive column or columns affected so that the net amount of the bill will agree with the net amounts distributed. These red ink items are, of course, deduction items and, when the various columns are totaled, either the net total may be shown or two totals on the one line, the one in red ink being the total of all red ink items in the column, the other in black ink being the total of all black items. Where two totals are shown, these will usually be posted to opposite sides of the same account. Thus in the Vouchers Payable account, the black total will be posted to the credit and the red total to the debit. In the distributive columns, the two totals will be posted in reverse. In a mercantile business, the Merchandise Purchases column, instead of being posted as just indicated, may have its black total posted to the debit of merchandise Purchases account, and the red total posted as a credit to Purchase Returns and Allowances account set up for that purpose.

Issue of Substitute Voucher.—An alternative method for entering purchase returns and allowances under the voucher system provides for the complete cancellation of the original voucher and the issue of a new one for the net amount of the bill in its place. This may be accomplished by means of an entry in the general journal, somewhat as follows:

Vouchers Payable (#369)	$1,275.00	
Vouchers Payable (#598)		$1,210.00
Purchase Returns and Allowances (or other suitable account title)		65.00
To cancel Voucher #369 and authorize its reissue in Voucher #598, on account of return of unsatisfactory merchandise.		

The credit here shown to Purchase Returns and Allowances will be made to the account to which original distribution was made of the debit analysis of the transaction, in order to adjust it to the necessary net distribution. The method by red ink adjustment is usually preferred because it entails less bookkeeping.

Special Column in Voucher Register.—Sometimes a special distributive column headed "Purchase Returns and Allowances" may be used in the voucher register. In that case, the red ink entry will be made in the Vouchers Payable column, and a black ink entry on the same line in the Purchase Returns and Allowances column.

NOTES PAYABLE UNDER VOUCHER SYSTEM

Vouchering Payment of Note—When Note Is Payable at Bank —When Voucher Check System in Use

Issue of Vouchers upon Payment of Notes.—Under the voucher system, it is customary to make a voucher for every transaction which will ultimately result in a cash disbursement. This procedure when applied to notes payable at the time when the note is issued, does not work satisfactorily.

The issue of a voucher and its entry in the voucher register for a note which will have to be paid some time in the future has the effect of converting the note payable liability into a voucher payable liability, inasmuch as the distribution of the voucher will have to be made to the debit of Notes Payable. This is not in accordance with the current status of the transaction. The proper procedure, accordingly, requires the holding up of the issue of the formal voucher until the time of payment of the note. A voucher is then made out and entered on the voucher register and the Notes Payable account is charged in the Sundry Debits column. The check is then drawn for payment of the note and entered in the cash disbursements journal. This results in a simultaneous conversion of the note payable liability into a voucher payable liability which is immediately canceled through the debit to Vouchers Payable account from the cash disbursements journal.

Notes Made Payable at Maker's Bank.—When, however, a note is made payable at the maker's bank, to be presented there for payment, a charge memorandum will be put through by the bank, from which posting will be made to the debit of the depositor's checking account. The canceled note and the charge memorandum are sent to the depositor as notification to him that his account has been charged for the amount of the note. Under such circumstances, the simplest procedure is to issue a voucher using the canceled note and bank debit memorandum as authority for it. This voucher will be entered regularly and extended into the Sundry Charges column where it will be charged to Notes Payable account. Also entry of the bank charge slip will have to be made in the cash disbursements journal. The charge slip itself should be given the next consecutive check number and treated as a canceled check, the amount being entered in Vouchers Payable column. If a voucher check system is in use, the voucher

VOUCHER DISTRIBUTION

Smith Engineering Company

19__

	VO. NO.	SUB. ACCT.	AMOUNT	VO. NO.	SUB. ACCT.	VO. NO.	AMOUNT	SUB. ACCT.	AMOUNT	VO. NO.	SUB. ACCT.	AMOUNT	VO. NO.	SUB. ACCT.	AMOUNT	VO. NO.	SUB. ACCT.	AMOUNT

Voucher Distribution Sheet

check—which is an integral part of the voucher entered on the voucher register—will have to be canceled and entered in the cash disbursements journal.

VOUCHER DISTRIBUTION BOOK

How Distribution Columns of Voucher Register May Be Expanded—Columnar Arrangement in Voucher Distribution Book

If provision for a very detailed analysis of the accounts to be charged in the voucher register is to be made, short-margin insert sheets may be placed in between two full-margin sheets. These insert sheets carry only money columns. In this way expansion of the distributive columns of the voucher register to almost any extent desired can be made, the entry of the name of the creditor and other data on the left-hand portion of the full-margin sheet applying to these short-margin distributive sheets as well.

Where the classification of the accounts to be debited is extensive, and these distributive sheets are many, they are bound separately in a loose-leaf volume which is known as the voucher distribution or voucher distribution book. An example of such record is shown opposite. Note that there are three columns for each major debit account—one for the voucher number, one for the number of the sub-account, and another for the amount with which that sub-account is debited. At the end of the month, by means of an adding machine, the charges to each sub-account in each major column are summarized for posting.

RECORDING CASH PURCHASES

Postings When No Accounts Kept with Vendors—Use of Cash Purchases Account—Cash Purchases under Voucher System

Accounts Kept with Vendors.—Restricting the term "cash purchases" to purchases in which an immediate cash settlement is made, as against those made on credit but paid for in a few days to take advantage of a discount offer, the method of recording such purchases is similar to that of recording cash sales (see page 184). If it is desired to keep a record of the total volume of business done with each vendor, the entries will be like those for purchases made on account. In other words, no distinction will be made between cash and credit purchases.

No Accounts Kept with Vendors.—If, however, cash purchases are to be recorded without reference to the vendor, the only entries will be a debit included in the total debits posted to the Purchases account through the purchase journal, and a credit included in the total credits posted to the Cash account through the cash disbursements journal. In other words, there will be no individual credit posting from the purchase journal or debit posting from the disbursements journal, and in each case this will be indicated by entering a check or other mark in the folio columns of the two special journals.

Instead of the foregoing procedure, the method is used at times of posting in full the entry in each journal as follows: the cash disbursements journal entry, debit Cash Purchases account and credit the Cash account; and the purchase journal entry, debit Purchases and credit Cash Purchases. By this procedure the Cash Purchases account will always be in balance, so that the postings to it will not duplicate those made to the Purchases account.

Cash Purchases under Voucher System.—If a voucher system is used and all disbursements are made by check, all cash purchases are first entered on the voucher register and immediately closed out through the entry on the check register. This procedure coincides with that of purchases made on account.

HANDLING PARTIAL PAYMENTS UNDER VOUCHER SYSTEM

Cancellation of Old Voucher and Reissue of New One—When Partial Payments Become Too Frequent

The voucher system is built on the idea that full payment will be made of the voucher for each transaction. No provision is made for canceling only a part of a voucher. Accordingly, where partial payments are to be made, the method of canceling the original voucher and reissuing it in whatever number of new vouchers it is planned to make payment, must usually be followed. This may be done either by formal entry on the general journal somewhat similar to the entry made in handling purchase returns and allowances under the voucher system (see page 164); or, better still, in the Paid column of the original voucher may be entered the numbers of the new vouchers in which the old has been reissued. This entry thus cancels the old voucher and reissues it in the new. The amounts of these new vouchers will be entered in the Vouchers Payable column and extended in the Sundry Charges column where they will be shown as debits to Vouchers Payable account and from which they will be so posted. If partial payments on vouchers become frequent, it indicates a situation to which the use of the voucher register for ledger purposes should be discarded and an accounts payable ledger used in its place.

TAKING AN INVENTORY OF MERCHANDISE

Counting and Valuing Merchandise—How "Cost or Market, Whichever Is Lower" Is Determined—Steps Followed in Taking Inventory

Physical Count and Valuation of Inventory.—The unsold goods on hand at the close of the fiscal year are referred to as merchandise inventory. Since during the year no detailed record was kept of the additions to the stock on hand through purchases or withdrawals due to sales, except where the book or perpetual inventory system is used, it is necessary at the close of the year to ascertain the value of the inventory, as it then stands, since the profits for the year cannot be determined without it. This is done by determining the quantity of each kind of merchandise on hand and valuing it by applying an appropriate unit price. This counting and valuing is called "taking the inventory."

A correct balance sheet and profit and loss statement are largely dependent upon the accuracy with which the inventory is taken. Not only must the count be accurate as to quantity but the merchandise must be properly valued. A conservative business maxim frequently followed is "anticipate no profits, and provide for all losses." Applied to the valuation of inventories, it results in the rule very generally followed, of pricing inventories at "cost or market, whichever is lower" at the inventory date. Each item composing the inventory is valued at cost, which is the price paid for the article, or at its market value at the time of the inventory, if it is less than the cost. The market price is the price at which the article can be replaced by new purchases in the ordinary course of business. The rule applies to each item of the inventory, not to the totals. Thus in the following illustration,

Item	Cost	Market	Cost or Market, Whichever Lower
1..........	$ 5.00	$ 6.00	$ 5.00
2..........	4.00	3.00	3.00
3..........	6.00	5.00	5.00
	$15.00	$14.00	$13.00

the total ($14) of the inventory priced at market is less than the total ($15) of the inventory priced at cost; nevertheless, $13 is the valuation to be used under the rule, cost or market, whichever is lower.

Procedure in Taking the Inventory.—Taking a physical inventory consists of showing quantity, description, unit price, and amount of each item. The procedure is as follows:

1. The physical inventory is taken at the close of the accounting period.
2. The counting and listing of the stock is usually performed by persons employed in the department in question, and under the direct supervision of the head of the department.
3. Occasionally, however, outside parties are called in, either to "take" the inventory, or to check it as soon as it has been completed by employees.
4. Strict instructions should be given to those who take the inventory. These should cover the method to be followed and precautions to be observed. Written instructions are best.
5. Before the inventory sheets are handed out, they should be serially numbered to insure the return of all sheets.
6. If possible, the inventory sheets should be issued in advance to record the description of the goods listed (designating whether damaged, shopworn, or obsolete), where located, and so on. On the day when the inventory is taken the data previously recorded are checked, and quantities inserted.
7. The pricings, extensions, footings, and recapitulations should be made in the office. They should be checked by some person other than the one who makes the calculations in the first instance. This work is usually done by operators using automatic calculating machines.
8. The signatures of those who take the inventory (caller and lister) should be placed on each inventory sheet, so that responsibility for errors may be definitely placed.
9. The inventory should be taken in the shortest possible time, in order to avoid confusion because of the receipt of new goods and the shipment of old goods.

10. Consignments inward not yet sold should be separated from the inventory of goods purchased. Such goods should be listed on separate sheets, and must be excluded from the inventory total, because they are the property of the consignors.
11. All goods out on consignment should be listed and included in the inventory.
12. Invoices for all goods included in the inventory must be entered on the general books before closing. The inventory should include only merchandise, the bills for which were charged to Purchases account before closing.
13. Goods in transit (purchased but not yet received) are taken up through the following entry which affects the balance sheet only.

    Goods in Transit, Dr.
    Accounts Payable, Cr.

14. If the goods are bulky or are in large containers, use is sometimes made of "inventory tags" prepared in advance. Each item of the inventory with a description of the goods and their location, is given on each tag.

BOOK INVENTORY—STOCK LEDGER

Operation of Stock Ledger—Control Account in General Ledger —Pricing Merchandise Withdrawn from Stock

Book Inventory and Physical Inventory.—Other names for book inventories are "perpetual," "going," or "running" inventories. They are simply records on which is kept a statement of the quantity and sometimes value of the different kinds of merchandise, or in a manufacturing concern, of the different kinds of materials, semi-finished goods, and finished goods on hand. The accounts show all receipts of goods, in one column, and with all issues or withdrawal of goods in another column, and balance in a third column. The receipts and issues of goods may be listed as to (1) quantities only,

(2) prices only, or (3) as to both. For purposes of the book or perpetual inventory the merchandise should be priced at cost. Book inventories do not dispense with physical inventories, which should be taken periodically to check the accuracy of the perpetual inventory.

The advantages of perpetual inventories are:

1. Financial statements can be made monthly without taking a physical inventory at the end of each month.
2. The purchasing department is supplied with data necessary to enable it to keep stocks on hand between minimum and maximum limits.
3. Book inventories serve as a check on physical inventories, thus affording means of detecting theft, shrinkage, and shortage.

Stock Ledger.—Under the perpetual inventory system, the usual accounting procedure is to maintain a control account in the general ledger. Subsidiary to this is a stock ledger containing a card or sheet for each item or class of merchandise. The charges to these subsidiary ledger accounts are entered from the creditors' invoices. The credits are posted from the summary of duplicate sales invoices.

When but few articles are traded in and the quantities are small, it is easy to record the units sold and the number of units which should be on hand, thus obtaining a book inventory. When a variety of articles is traded in and there are many sales, the clerical expense of keeping track of quantities may be prohibitive. If so, quantity of goods on hand and the value thereof must be ascertained by taking a physical inventory.

Pricing of Merchandise Withdrawn from Stock.—The illustration below is a simple stock ledger for recording the quantity and value of particular commodities on hand. In this illustration, quantity issued is deducted from quantity purchased to ascertain quantity on hand. The pricing of

STOCK LEDGER														Commodity "y"		
Purchases							Issues—Sales							Balance		
Date 19–		Quantity	Unit Cost		Amount		Date 19–		Quantity	Unit Cost		Amount		Quantity	Amount	
Jan.	3	400	$1	25	$500	–	Jan.	4	25	$1	25	$31	25	375	$468	75
	5	350	1	20	420	–								725	888	75
	17	100	1	30	130	–		17	250	1	25	312	50	575	706	25
							Feb.	2	125	1	25	156	25			
									75	1	20	90	–	375	460	–

Form of Stock Ledger

issues and of the balance on hand is on the basis of first-in first-out; that is, the first invoice price of $1.25 is applied to all issues until 400 bushels, the amount purchased at $1.25 per bushel, have been sold.

"GROSS PROFIT" METHOD OF INVENTORYING

Procedure Illustrated—When Method Is Used—Conditions Rendering It Impracticable

General Rules in Applying Method.—The management of a business may desire to ascertain the financial condition and profits at a date when it is not practicable to take a physical inventory. If no perpetual inventory is kept, it may be possible to estimate the inventory by using a procedure which is commonly referred to as the "gross profit" method. The procedure is as follows:

1. Estimate the amount of gross profit included in net sales to date. The accuracy of the gross profit method of inventorying depends on the accuracy of this estimate.
2. Ascertain cost of sales by deducting the estimated gross profit from the net sales.
3. Add the net purchases to the opening inventory and from the total deduct the cost of sales as determined in 2 above. The remainder is the closing inventory.

Method Illustrated.—The application of this method is illustrated in the following example:

1.	Average sales per year over the number of years taken....	$ 5,250.00
	Average cost of purchases..............................	3,242.00
	Average gross profit..................................	$ 2,008.00
	% of average of gross profit to average sales............	38¼%
2.	Actual sales per books................................	$ 5,500.00
	Less—estimated gross profit on sales which is 38¼% on sales	2,103.80
	Estimated cost of sales—61¾% on sales..................	$ 3,396.20
3.	Inventory at beginning of period.......................	$ 4,936.00
	Purchases during the period............................	5,550.00
	Together	$10,486.00
	Deduct—estimated cost of sales (as above)...............	3,396.20
	Balance—estimated inventory at end of period............	$ 7,089.80

The estimated inventory is accurate only to the degree that the estimated percentage of gross profit is accurate. Therefore, the use of this method should be limited to those concerns whose products have a fairly uniform margin of gross profit. If such condition exists, this method may be used to determine the approximate inventory at the close of each month, thus making possible monthly balance sheets and statements of profits without having a perpetual or book inventory.

RETAIL METHOD OF INVENTORY

Inventorying on Basis of Selling Cost—Adjustment to Cost Basis by Application of Mark-Up Per Cent

When Method Is Used.—Every inventory should be taken at cost, since the taking of the inventory is but one step in ascertaining the cost of the merchandise sold and the gross profit on sales during the fiscal period just elapsed where no book or perpetual inventory of the various articles or materials composing the stock is kept. However, among retail stores, particularly department stores, it is a common practice to first take the inventory at selling prices. But this represents merely a short-cut method of arriving at the cost of the inventory. In retail establishments, with their stocks of miscellaneous goods, the detailed figures of cost for the various kinds of articles are not readily available. The selling prices naturally are. To save labor in taking the inventory, therefore, it is first made on the basis of the selling prices and then reduced by the average percentage by which the goods were marked up from their respective cost figures in fixing their selling prices.

Application of Mark-Up Per Cent.—In order to reduce an inventory valued at retail sale price, to a cost basis, the per cent of the mark-up of the cost price to give the original sale price must be found and applied. This per cent as usually expressed is based on the sale price and not the cost price, being determined by dividing the difference between the sale and cost price (that is, the gross profit figure) by the sale price. Thus, an article costing $60 and marked to sell at $100 will, if sold, yield a gross profit of $40, which, given in terms of the sale price, is a 40% gross profit. This 40% is spoken of as the "mark-on per cent." The cost as a percentage of the sale price is, therefore, the difference between 100% and the per cent of mark-on, which in the present example is 60%. That is to say, 60% of the sale price gives the cost price. This 60% is the cost multiplier by which the inventory value of goods at selling price is reduced to a cost price basis. The retail method of inventory, however, is applied to aggregate stocks of goods by departments or for the business as a whole, the cost multiplier being found by taking the aggregate cost of the beginning inventory adding the amount purchased during the period and comparing this total with the value of the goods on the basis of sale price.

A form for taking an inventory by the retail method is shown herewith. It is one recommended by the Controllers Congress of National Retail Dry Goods Association.

RETAIL INVENTORY METHOD

	(1) Cost	(2) Retail	(3) Mark-Up	(4) % of Mark-Up
1. Opening Inventory (lines 11 and 9 of preceding period)	$........	$........	$........	......
2. Purchases	....	....	....	......
3. Freight Express and Cartage, Inward	....	xxxxxxxx	xxxxxxxx	xxxxxx
4. Additional Mark-Ups, less additional Mark-Up Cancellations .	xxxxxxxx	....	....	xxxxxx
5. Total of Inventory, plus Additions .	$........	$........	$........	......
6. Net Sales	xxxxxxxx	$........	xxxxxxxx	xxxxxx
7. Mark-Downs, less Mark-Down Cancellations	xxxxxxxx	....	xxxxxxxx	xxxxxx
8. Total Retail Deduction (sum of items 6 and 7)	xxxxxxxx	$........	xxxxxxxx	xxxxxx
9. Resultant Retail Inventory (Retail Inventory on line 5, Column 2, minus item 8	xxxxxxxx	$........	xxxxxxxx	xxxxxx
10. Calculation of Cost Percentage: (a) Total Percentage . 100% (b) Percentage of Mark-Up (line 5, Column 4) . . ...% (c) Percentage of Cost [(a) minus (b)] . . . .%				
11. Cost of Inventory [item 10 (c) applied to item 9]	$........	xxxxxxxx	xxxxxxxx	xxxxxx
12. Resultant Mark-Up and Percentage (item 9 minus item 11) . . .	xxxxxxxx	xxxxxxxx	$........	......
13. Gross Cost of Merchandise Sold (difference between Cost Inventories on lines 5 and 11) . . .	$........	xxxxxxxx	xxxxxxxx	xxxxxx

INVENTORY TURNOVER

Ratio as a Significant Index of Management of Inventory Investment—Two Bases of Computation

Significance of the Ratio.—The inventory turnover is the ratio of the volume of sales for a given period to the average amount of the inventory and expresses the rapidity with which the stock of goods is turned over, that is to say, sold out and replenished. The ratio is a convenient figure used to measure the relative efficiency with which the investment or money tied up in inventory is being managed. The higher the ratio and the more rapid the turnover, the smaller is the amount of capital tied up in stock-in-trade to handle a given volume of business, and the larger is the return earned on the capital, since with each turnover a margin of profit is realized and discounts are earned.

Method of Computation.—The turnover is computed by taking the average inventory for the period and dividing it into either the volume of sales or the cost of the sales for the period. The average inventory may be determined either by taking an average of the beginning and the ending inventory of the accounting period, or by taking an average of the monthly inventory figures, if they are available. Whichever basis—sales or cost of sales—is adopted in figuring the inventory turnover, it should be consistently used; otherwise the comparison of ratios between periods will not be valid.

Example:

Beginning inventory at cost	$15,754.43
Ending inventory at cost	13,832.53
Total of both inventories	$29,586.96
Average inventory—total divided by 2	$14,793.48
Cost of sales for the period were	$30,639.37
Inventory turnover for the period	2+

ACCOUNTS PAYABLE ACCOUNT IN THE GENERAL LEDGER

Controlling Account for Subsidiary Ledger—Entries Made in the Account—Agreement Between Controlling Account and Creditors Ledger

Posting the General or Controlling Account.—When individual creditors' accounts are kept in a separate subsidiary ledger, a summary account must be opened on the general ledger, which will control, or serve as a check on the accuracy of, the postings made in the creditors ledger. Postings to this controlling account are made weekly or monthly in summary totals, as follows:

Credits from the Purchase Journal.—When the purchase journal is summarized and posted at the end of the period, the entry is a debit to Purchases account and a credit to Accounts Payable controlling account on the general ledger for the total purchases.

Debits from the Cash Disbursements and from the Returned Purchases and Allowances Journal.—When the cash disbursements journal is summarized and posted, at the close of the week or month, the entries are as follows: A debit to the Accounts Payable controlling account for the total of the Accounts Payable column of the cash disbursement journal and a credit to Cash, and a debit to Accounts Payable account for the total of the Discount on Purchases column of the cash disbursements journal and a credit to Discount on Purchases.

Likewise, when the purchases returns and allowances journal is summarized and posted, at the end of the period, a debit for the total of the amount column is posted to the Accounts Payable controlling account in the general ledger, and a credit to Purchase Returns and Allowances account.

Agreement Between Creditors Ledger and Accounts Payable on General Ledger.—During the period, the amounts due the individual creditors for purchases are posted from day to day by crediting their respective accounts in the creditors ledger. Debit postings are also currently made to the creditors' accounts for payments made, and for all returned purchases and allowances. It is, therefore, evident that the aggregate of the balances of the individual creditors' accounts at the end of the week or month should agree with the balance of the Accounts Payable controlling account in the general ledger. This fact is availed of by way of checking the accuracy of all postings during the period just closed. As soon as the postings to the Accounts Payable controlling account are completed, the comparison is made, and if there is any discrepancy, a search is made for the error.

PROVING THE ACCOUNTS PAYABLE LEDGER

Proving Correctness of Postings Against Controlling Account—Against Statements of Accounts Received from Creditors

Method of Proving.—When an accounts payable or creditors ledger is maintained to hold accounts with individual vendors or creditors, it is necessary to prove periodically the correctness of the postings. This is done at the end of the month or other period when the several journals from which the postings are made—the purchase journal, the cash disbursements journal, and the returned purchases and allowances journal or general journal—are summarized and closed, and the totals are posted to the Accounts Payable controlling account on the general ledger.

For the purpose of proving its correctness no actual trial balance can be taken of the creditors ledger, because the ledger does not balance. The individual accounts with creditors generally have credit balances, and only occasionally and in relatively few instances will there be a debit balance, resulting from payments made to or credits received from vendors in excess of the purchases.

Schedule of Accounts Payable.—The general method of proving is to compare the balance of Accounts Payable on the general ledger with the total of the balances taken from the individual accounts in the creditors ledger. The total net balance of the creditors ledger is ascertained by drawing up a schedule of the balances due to the several creditors, as shown below:

Schedule of Accounts Payable

July 31, 19–

M. O. Sprague	$457.00
J. L. McIntosh	234.00
The J. P. Smith Co.	156.00
Total Accounts Payable—General Ledger	$847.00

Where there are any debit balances, these may be grouped in a separate list under the credit balances and subtracted from the latter. Or if they occur often enough, two amount columns may be provided—one for the credit balances and the other for the debit balances. While such a schedule is not actually a trial balance, it is nevertheless frequently referred to as the accounts payable ledger trial balance.

Comparison with General or Controlling Account.— The total net balance as shown by the schedule should agree with the balance of the controlling account on the general ledger, since the postings to both creditors ledger and the controlling account are made from the same source, the several journals. The only difference is that in the case of the creditors ledger, the individual items in the journals were posted separately, while in the case of the Accounts Payable account in the general ledger, the monthly or other periodical totals of the items were posted. If there is any difference, an error has been made either in posting the individual items to the creditors ledger, or in summarizing the journals or in posting the totals to the Accounts Payable account on the general journal.

This method of proof only applies to ascertaining the correctness of the amount of the postings. It cannot serve as a check on the posting to the individual accounts nor on the correctness of the original entries made in the journals. For the latter purpose the statements of account received from the creditors should be examined to see whether they agree with the accounts in the creditors ledger.

RECORDING OF CASH SALES

What a Cash Sale Is—Two Methods of Recording—Posting Entry Where No Vendor's Account Is Kept

Accounts Kept with Individual Customers.—Cash sales are sales for which payment is received immediately. Sales made on credit but with an offer of a discount allowance (the so-called cash discount) if payment is made within a few days, generally ten, are sometimes referred to as cash sales if the discount is taken. However, for present purposes only the former class of sales are considered. These may be recorded in two ways. If, for example, in a wholesale trading business, the sales or credit departments desire to keep a record of all sales made to individual customers, whether on cash or credit terms, cash sales will not be distinguished from sales made on credit so far as the record of the cash received is concerned. If, for example, a cash sale of $100 is made to Thomas Smith, an entry will be made through the sales journal, debiting his account and crediting Sales. At the same time an entry will be made through the cash receipts book, debiting Cash and crediting Thomas Smith. Thus, his account will at one and the same time receive a debit and a credit entry, each for $100, and his account will show no balance. The purpose of the record is not to show any balance owed by him, as none is owed, but simply the total volume of sales made to him.

No Accounts Kept with Individual Cash Buyers.—On the other hand, it may not be considered necessary to keep a record of the cash sales made to individual buyers. This is particularly true in a retail trading business. In that event, the only entries will be a credit to Sales through the sales journal and a debit to Cash through the cash receipts journal, and in each journal the brief explanation will be "Cash Sale" without any mention of the name of the buyer. Here special care must be exercised in posting in order to avoid duplicating entries. As the credit entry for the transaction will be included in the total posted from the sales journal, no individual credit posting should be made from the cash receipts journal, and to indicate this the bookkeeper should place a check (√) or other mark such as S. B. (sales journal) in the folio column of the cash receipts journal. Contrariwise, since the debit entry will be included in the total posted from the cash receipts journal, no individual debit posting should be made from the sales journal and this will be shown by placing a check or other mark, as C. B. (cash book), in the folio columns of that journal.

CONTROL OF CASH SALES

Control in a Retail Establishment—Control of Cash Sales in a Factory

Retail Cash Sales.—The fundamentals to be borne in mind in planning for control of retail cash sales from a record standpoint are: (1) the purchaser should receive a consecutively numbered cash or counter slip or an invoice in exchange for his cash; (2) a copy of such cash slip should remain in the hands of the selling organization, either with the cashier or the sales clerk, and in some cases with both; (3) provision should be made for daily summarizing the sales slips of each clerk and of each department; and (4) internal check or audit should go on continually between the records of the departmental sales clerks and the cashiers.

Cash Sales of Scrap in Factory.—In factories and other establishments where the number of daily cash sales transactions is small, there nevertheless may be considerable risk of loss through cash sales of scrap, boxes and other containers, as well as through occasional sales of finished product. Wherever practicable to do so, deliveries should be made through the shipping department, authorized by a cash sales ticket from the cashier specifically setting forth what should be delivered to the cash purchaser. The use of passes for packages or trucks going through the factory gate has been found practical and has prevented the disappearance of assets which might otherwise have been carried off without being paid for. Receipted invoices for cash sales are sometimes used in place of such passes. The watchmen should collect the cash sales slips and turn them over to the auditing department as a check against the cash sales receipts and also to prevent their use again on another day to pass wrapped and pilfered articles.

BACK-ORDER MEMO

Purpose Served by Back-Order Memo—Notification to Customer of Items "Back-Ordered"

A purchase order may include items which cannot be shipped immediately because they are out of stock. Provision must then be made for later shipment when the goods are available. This is done by issuing a back-order memo, for filling the order at a later date. The items which cannot be shipped are entered in the invoice without any entries for prices or amounts, and are either marked "Back-Ordered," or a notation is made in the invoice to the effect that the goods are not in stock at the moment, and will be sent as soon as they are in stock, if agreeable to the customer. For the items that cannot be shipped a back-order memo, similar to the form appearing in (a), is prepared and filed away in a back-order file, or if suitable in a binder. The back-order memo serves the same purpose as another order from the customer to be filled at a later date. When the merchandise in question is again in stock, the back order is handled in the regular routine of an original sales order. If the entire

B 2657

THEIR ORDER

BACK ORDER ________________

ACKNOWLEDGED______________READY ON OR ABOUT____________

(a) Form of Back Order

THE GERALD DRY GOODS CO.
15 EAST 3RD ST., NEW YORK, N. Y.

B 2657

YOUR ORDER

ACKNOWLEDGMENT ________________

ACKNOWLEDGED______________READY ON OR ABOUT____________

AS SOON AS THIS ITEM IS AVAILABLE, IT WILL BE SHIPPED IN ACCORDANCE WITH YOUR INSTRUCTIONS.

(b) Acknowledgment of Order Which Is "Back-Ordered" order must be "back-ordered," a duplicate of the back-order memo with a note of explanation is mailed to the customer. Or a special acknowledgment of the receipt of the order, containing a statement that shipment will be made as soon as the items ordered will be available, is sent. A form of such acknowledgment is shown in (b).

SALES RETURNS AND ALLOWANCES

Request for Credit for Return or Allowance—Posting of Returns and Allowances Journal—Treatment in Profit and Loss Statement

Credit Memorandum.—After receiving a shipment, and checking it against the invoice and his purchase order, a customer may find the shipment or a part of it unsatisfactory and may wish to return it. Or the shipment may be deficient

L. H. SMITH, INC.
10 STATE ST.
BOSTON, MASS.

CREDIT MEMO. NO.________

________________ DATE________________

____

____

WE CREDIT YOUR ACCOUNT AS FOLLOWS:

REASON FOR CREDIT	AMOUNT

L. H. SMITH, INC.
PER____________

Credit Memorandum

in quality or short in quantity and he may desire an allowance on the invoice. He will then request credit for such return or allowance. The granting of such credit will be evidenced by a credit invoice or memorandum prepared on a form similar to the one shown herewith.

This memorandum, printed on paper of some distinctive color, usually red, so as to distinguish it readily from the regular invoice, will be issued in duplicate. The original, signed by one who is authorized to allow such credits, will be sent to the customer, while the carbon copy, initialed by the same person, will be routed to the bookkeeper in charge of the customers ledger, who will file it in a binder kept for the purpose after making the proper entries. When goods are being returned, the credit memorandum will not be issued until the goods arrive in the receiving department, and are checked and verified.

Recording Sales Returns and Allowances.—The entries for all credit memoranda evidencing sales returns and allowances are credited to the customers' accounts and debited to Sales Returns and Allowances account. Since the amount of such returns is a check on the efficiency of the sales and shipping departments, a separate account for them is kept instead of merely passing a debit to Sales. The entry may be made through the general journal as follows:

Sales Returns and Allowances........................	\$28.25	
To A. Brown....................................		\$28.25
Allowance on Sale as per Invoice No. —.		

Returns and Allowances Journal.—When the volume of business is large and such returns and allowances are frequent, a separate sales returns and allowances journal, ruled similar to the form below, may be used. Note the column for the number of the credit memo, by means of which the memo in question can always be referred to in the filing binder. These credit entries are posted daily to the customers' accounts, in order to keep the balances of these accounts constantly up to date. The debit entry for the total of the amount column is made, weekly or monthly, as the case may be, to Returned Sales and Allowances account in the manner shown in the form, the offsetting credit being to Accounts Receivable control account on the general ledger.

Date		L.F.	Name of Customer	Credit Memo No.	Amount	
19—						
May	10	2	S. R. Wright	1	75	–
	15	8	E. T. Taylor	2	38	–
	23	6	John Green	3	10	–
	25	7	L. S. Smith	4	5	–
	31		Returned Sales and Allowances—debit		128	–

Returned Sales and Allowances Book

In the profit and loss statement, the balance of the Returned Sales and Allowances, which is a debit, will appear as a deduction from Sales, or may be deducted from the sales before showing the latter on the statement.

FORM AND OPERATION OF SALES JOURNAL

Making Debit and Credit Postings—Several Methods of Closing Sales Journal—Form for Analysis of Sales

Form of Sales Journal.—The sales journal is the book of original entry for all sales of stock-in-trade, whether made for cash or on credit, and to that extent it replaces the general journal. A simple form of sales journal is shown in (a). A separate line is used for the entry of each sale. The book is ruled to show the date of entry, the number of the invoice representing the sale, the name of the customer and his address, the terms of sale, the folio of the ledger on which the customer's account to be debited appears, and the amount of the sale, made on account or credit.

The entries in the journal are made from day to day as soon as the goods have been shipped and the invoice has been mailed to the customer. The basis of the entry, or the bookkeeper's authority to make it, is a carbon copy of the invoice which is routed to him from the billing department. The copy provides him with all the necessary information to make a complete entry as called for by the ruling of the sales journal. If the sale is a cash sale and no accounts are kept with cash customers, instead of entering the name of the customer, only the word "cash" need be entered. If, however, accounts are kept with cash customers as well as with those who buy on account, then the name of the customer with an explanation of "cash" is entered.

Date		Inv. No.	Name	Address	Terms	F	Amount	
19—								
June	1	1	Richard Robbins	Utica, N. Y.	2/10 n/30		255	–
	2	2	John Duncan	Trenton, N. J.	On a/c		245	–
	30	3	J. V. Newman	Buffalo, N. Y.	On a/c		390	–
	30		Mdse. Sales, Cr.				890	–

(a) Simple Form of Sales Journal

Posting and Closing of Sales Journal.—In posting the sales journal, the debits are to customers' accounts and the credits to Merchandise Sales account. In order to keep the information as to customers' balances up to date, the debit entries must be posted daily. As each posting is made, the ledger page of the account charged is entered in the folio column. If, however, it is a cash sale and the name of the buyer is not indicated, no debit entry is made and this will be indicated by a check-mark ($\surd$) made in the folio column. The debit entry will be made instead from the summary of the cash receipts journal.

No credit entries are made to the Sales account until the end of the week or month, whichever period is used. The amount column is then footed and ruled as shown in form (a) above, and the total amount is posted to the credit of Sales. The journal entry for this summary posting is made on the sales journal as appears in (a). The sales journal is then closed by double rulings, and the next period's sales begin a new series of entries on the next page.

Another method of closing the sales journal is shown in (b). Note that a special column is provided for entering

SALES JOURNAL

Date 19—		Account to be Debited	Terms	F	Dr. Customer		Cr. Sales	
Jan.	4	D. C. Tapp	Cash	√	450	–		
	6	D. C. Tapp	n/30	√	400	–		
	17	Morton & Company	n/20	√	1,500	–		
		Davis Supply Company	n/10	√	1,268	75		
	26	A. D. Taylor & Company	n/30	√	500	–		
	31	Sales, Cr.		71			4,118	75

(b) Another Form of Sales Journal

the total credit to be posted to Sales. In this form the folio column, so far as the individual debit postings to the customers' accounts are concerned, is used merely for the purpose of inserting a check-mark when each posting is made. The individual customers' accounts are kept in a separate loose-leaf ledger, arranged in alphabetical order. The accounts can, therefore, be readily located without any need of cross-indexing in the sales journal.

Columnar Sales Journal.—Frequently the form of the sales journal is expanded by having additional columns to provide for an analysis of sales. Form (c), for example,

Date 19—		No.	Customer	F	Total		On Acct.		Cash	
Apr.	3	47	Cash Sale	√	1,000	–			1,000	–
	3	48	C. D. Hughes	39	875	–	875	–		
			(*etc.*)		40,592	15	33,751	20	6,840	95
	30		Accounts Receivable	17	33,751	20				
			Cash Sales	√	6,840	95				
			Merchandise Sales	24			40,592	15		
					40,592	15	40,592	15		

(c) Three-Column Sales Journal

includes columns for sales made on account and cash sales. Form (d) furnishes an analysis of sales according to classes of merchandise sold. A column may be included for each class of merchandise recorded in the sales journal. The book can be expanded in this way to provide for a very detailed analysis of sales if desirable. In closing this columnar

RECORD OF SALES January 19–

Day	Inv. No.	Sold to	Terms	F	Dr. Customer		Cr. Sales of Drugs		Cr. Sales of Stat'y	
4	1	D. C. Tapp	Cash	√	450	–	400	–	50	–
6	2	D. C. Tapp	Net 30 days	√	400	–	400	–		
17	3	Morton & Company	Net 20 days	√	1,500	–	1,500	–		
	4	Davis Supply Company	Net 10 days	√	1,268	75	1,268	75		
26	5	A. D. Taylor Company	Net 30 days	√	500	–			500	–
					4,118	75	3,568	75	550	–
							(71–x)		(71-y)	

(d) Form of Sales Journal with Additional Columns to Provide for Analysis of Sales

or analytical form of sales journal, the summary credit posting may be for the amount of the total sales to one general Sales account, or the total of each analytical column may be posted to an account recording the particular class of sales.

In the latter case, the posting reference is placed immediately under the total of each analysis column. The book is "balanced" by cross-footing the analysis columns to determine that their totals, when combined, equal the total of the "Customer" column.

BILLING INVOICES

Necessity for Correct Billing—Various Methods for Insuring Correct Entries of Shipments

Work of Billing.—"Billing" or "invoicing" is the work of preparing and mailing out invoices for merchandise shipments, and is performed by a special clerk in the accounting department, and in the larger organization, with many shipments made daily, by a division of the credit department, called the "billing department." In a large organization, billing is from copies of customers' orders or the shipping memoranda and is done on ordinary typewriters, or, when a heavy volume of business is transacted, special billing machines are used to increase the output per worker. These billing machines usually represent a combination of a typewriter and a calculating device.

Correct Billing Essential.—Great care must be taken in billing invoices. Overcharges create bad feeling in the customers, while undercharges result in direct losses, since the customers may not report the undercharges. Moreover, a dishonest clerk in collusion with a customer may fail to bill the latter, and as the entries of sales on the books are made from duplicates of the invoice, there will be no record made of such a sale. Accordingly, one of the most important functions of internal auditing is to see to it that all merchandise shipments are properly accounted for. So far as possible automatic checks are established. In order that the shipment may tally with the invoice, two independent counts of the goods may be made if the value of the goods warrants the expense of such counts. Prices at which goods are billed have to be carefully verified in the accounting department against the sales order as received from the selling department. On shipments made f. o. b. shipping point, the vendor may pay the freight and add the cost to the invoice cost of the shipment. The additional charge must be verified by a clerk familiar with freight rates, and in a large organization this is one of the duties of the traffic department. Other errors or frauds in billing are possible, and as sales are a concern's chief source of income, on which it relies to pay expenses and net a profit, various checks are set up in well-managed businesses to insure that customers will be billed for the actual amounts of the shipments, and that these amounts will be truthfully and correctly recorded in the sales journal and the customers ledger.

One simple method used is for the shipping department to return the shipping orders, with an adding machine slip showing the total of the shipments, to a clerk or department performing an auditing function. A similar adding machine slip showing the total of invoices billed is prepared in the billing department. The totals of the two slips should agree.

FREIGHT NOTICE AND EXPENSE BILL

Notice Sent by Railroad of Arrival of Shipment—Billing Consignee for Freight Charges

A notice, called "freight notice" or "arrival notice," is sent by the railroad to the consignee upon arrival of the goods. A more or less formal order is given by the consignee to the drayage company to call for the freight. This order authorizes the railroad to deliver it to the drayage company. Upon its delivery, an "expense" or freight bill is sent to the consignee itemizing the freight charges due on the shipment. The freight notice and the freight bill are usually made at one impression, the heading on the one being a notice of the arrival of freight, while on the other the heading is that of an ordinary invoice or bill showing the freight charges on the designated goods. Some railroads make three copies at one impression, consisting of: (1) the freight notice, (2) the delivery receipt, and (3) the freight bill. Copy 2 is a receipt surrendered by the consignee upon delivery of the goods.

SALES INVOICE

Number of Copies of Sales Invoices Used—The Invoice as Basis of Entry in Sales Journal

Purpose and Form.—The sales invoice is the bill which is mailed to the customer upon making shipment of his order. It is employed by wholesaling, jobbing, and manufacturing concerns, and does not differ in essentials from the sales ticket which accompanies merchandise sold by a retail business.

There is no standard form of invoice, and each business determines its own form according to its preferences and requirements. An example is shown below. It is a simple document designed to contain the information originally conveyed by the customer's order, and its purpose is to notify the customer of the shipment and that he is now indebted for the sum named. A good invoice contains the date of shipment and routing, terms of sale, name and address of the customer, merchandise shipped, unit prices, extensions, and total amount due.

Number of Copies Used.—The invoice, upon its receipt by the customer, is held until the merchandise shipment arrives, when the goods are checked against it. Prices and extensions are verified, and if found correct, the invoice is passed for payment. The copy of the invoice retained by

SIMPLIFIED INVOICE

[YOUR Name, Address and Trademark Go Here]

CUSTOMER'S ORDER NO. & DATE 784 9/5/19—
REQUISITION NO. 28,453
CONTRACT NO. 12,580

REFER TO INVOICE NO. 40933
INVOICE DATE 10/8/19—
VENDOR'S NOS. AC48786

SOLD TO John Duncan
894 Pacific Street
Portland, Ore.

SHIPPED TO AND DESTINATION Same. Portland, Ore.
DATE SHIPPED 10/8/19— FROM N.Y.City
CAR INITIALS AND NO. NP897,643 F.O.B.
HOW SHIPPED AND ROUTE Fast Frt. N.Y.C.
TERMS 2/30, n/60

PREPAID OR COLLECT? Collect

FOR CUSTOMER'S USE ONLY

REGISTER NO. 13279 VOUCHER NO. 4281
F.O.B. CHECKED R.T.S.
TERMS APPROVED CEW PRICE APPROVED RK
CALCULATIONS CHECKED BWC
TRANSPORTATION 238576 FREIGHT BILL NO. $38.72 AMOUNT
MATERIAL RECEIVED 10/24/19— DATE JAD SIGNATURE Rec. Cl. TITLE
SATISFACTORY AND APPROVED
ADJUSTMENTS
ACCOUNTING DISTRIBUTION Shoes
AUDITED CCH FINAL APPROVAL MEC

QUANTITY				DESCRIPTION	UNIT PRICE	AMOUNT
Case	1	24	pr.	Cf Blu C1784H	4.80	115.20
"	1	24	"	PG Oxfords A-E4390L	5.25	126.00
"	2	36	"	W. St Sand. AA-CC7862K	3.85	138.60
				Total		379.80

Standard Invoice Issued by the National Association of Purchasing Agents

the seller provides the basis for formal entry in the sales journal from which the charge is made to the customer's account. Sometimes copies of the sales invoices are bound together to form a sales book. In that event the postings to the customers' accounts are made directly from the copy of the sales invoices.

Several copies are made of the invoice by the seller—at least one original and two carbons. The original is mailed to the customer, while one carbon copy is used as a basis for making entry in the sales journal, and the other for posting to the accounts receivable ledger. Frequently additional copies are made for the use of various departments interested. For example, one copy may be sent to the sales department for use in making up a list of salesmen's sales, one to the salesman who got the order, one to the traffic department for its records, and one to the statistical department for its analytical studies of the sales. The invoices are usually numbered serially, all copies bearing the same number.

HANDLING CUSTOMER'S ORDER

Use of "House Order" Blank—Recording of Order Before Shipment and Formal Book Entry—"Tie-Up" Between Shipments and Invoices

Form of Order.—Orders for a company's merchandise or product may arrive in any one of a number of different forms—on a regulation order blank of the house, filled out at the office or mailed in by salesman or customer, by ordinary letter, by telegram, or by word of mouth given personally or over the telephone. The salesman may take the customer's order on a "house order" blank, securing his signature to the order, which thus constitutes a formal contract between the house and the customer. All large wholesalers and manufacturers provide sales order blanks containing the provisions of their standard sales contract, and space for dating, customer's name, address, shipping instructions, and details of goods ordered.

Acceptance and Recording of Order.—Upon the arrival of a customer's order in whatever form, the first step is to decide upon its acceptance. The goods ordered may not be of the kind which the house can deliver, or the terms exacted by the customer may not be satisfactory, or if a cash remittance does not accompany the order, his credit standing will have to be passed upon unless he is known as good for the amount involved. In a large organization, the order will first be referred to the credit department to get its approval of the amount of credit to be extended to the customer.

In every organization some system is provided for taking proper care of orders upon their arrival. The "order clerk," or in a large organization the "order department," handles this. Because of the practice of canceling orders by the customer, before they are filled, it is not customary to make a formal entry of the sales order on the books of account until the order has been filled and delivered. Nevertheless, some

INCOMING ORDER BLANK

Order No.__________
Date__________

Name________________________

Address________________________

Telegraph__________
Telephone__________
Mail__________
Personal__________
Salesman__________

QUANTITY	DESCRIPTION	PRICE
		ORDERS TAKEN BY

House Form for the Immediate Recording of an Order record must be immediately made of the receipt of the order and this may be done by the order clerk giving the order a serial number and entering it in a memorandum book, often termed a sales or order register. Or the order may be entered on a memorandum slip similar to the form shown.

Invoicing and Shipment.—Where comparatively simple machinery for handling sales orders is provided, the order filled out, say on a salesman's form, goes to the billing clerk who prepares an invoice in triplicate. One carbon copy of the invoice is routed to the stock and shipping room for order filling and shipment, and it is there initialed by the shipping clerk when shipment is made and returned to the accounting department, where it is filed in the order of its number, in a binder serving as a shipping record. Meanwhile, the accounting department has checked the other carbon copy of the invoice against the order and verifies the correctness of the terms, prices, extensions, and footing. Upon receipt of the initialed copy from the shipping room, it mails the original copy of the invoice to the customer, and files the carbon copy which it had retained in a sales binder from which the bookkeeper makes his formal entries on the books of account.

In most business offices, the invoice is not usually prepared until some shipping memorandum has been received from the delivery department. The invoice is then prepared from a copy of the shipping report and the seller is sure that no items are included on the invoice which have not been shipped for some such reason, as because they are "out of stock." If the invoices are prepared from sales orders, there may be delay or corrections may have to be made if it is subsequently discovered that the goods were not, or could not, be shipped.

Frequently upon receipt of a sales order and its approval by the credit department, it is given a serial number and is transcribed on a "house order" blank. In the transcription a number of copies are made, which may be as many as six or more, one or two of which may, for example, serve as the invoice sent to the customer, another as a packing slip accompanying the merchandise, and another may be sent to the sales department for filing. The purpose of using so many copies of the customer's order is principally to assure that the billing clerk and the shipping clerk shall have identical information and effect a complete "tie-up" between shipments and invoices, from the latter of which the customer is charged.

CUSTOMERS' MONTHLY STATEMENTS OF ACCOUNTS

Various Purposes for Mailing Statements—Various Forms of Statements—Statements Prepared on Bookkeeping Machines

Periodic Mailing of Statements.—In most businesses, periodic statements of accounts, usually monthly, are mailed to customers if their accounts show a debit balance. Where the arrangements with customers are for monthly settlement, the purpose of the statement is to ask for such payment of the amount due as indicated on the statement. Where, however, the terms of payment are a certain number of days from the invoice date, as 30, 60, or 90 days, the purpose of the statement is simply by way of verifying the correctness of the account with the customer. If there is a discrepancy, the matter is taken up with the vendor and adjusted, so that the next month begins with all accounts completely confirmed by customers.

Forms of Statements.—The statements are transcripts (sometimes a summary) of the customers ledger accounts, and accordingly contain all charges and all credits for the period covered. If there is a balance outstanding at the beginning of the month, the current statement opens with the balance, and is followed first by a list of charges and then of payments and other credits for the period. The total credits are subtracted from the total charges, and the balance constitutes the amount now due. The totals, including the final balance, are entered in a separate column.

Statements of account differ in form. One form has been described in the foregoing paragraph. A common form (see page 24) is one which provides separate columns for entering the debits and the credits, each against its respective date, and a third column to show the balance that was due at the beginning, the balance after each debit or credit entry was made, and the balance at the end of the period. Such form of statement is readily adaptable to use with bookkeeping machines.

Companies which use bookkeeping machines to keep their accounts receivable make duplicates of the accounts on statement forms which they send to the customers. At the beginning of the month, a statement is inserted with each customer's ledger sheet, and as entries are made on the sheet during the month, they are duplicated on the statement form by means of a carbon sheet, or by a parallel mechanical device. At the end of the month, all statement forms are removed from the binder or file and mailed to the customers.

ESTIMATING BAD DEBTS

Estimating Collectibility of a Particular Account—Making a Blanket Estimate Loss—"Aging" Accounts

Principal Methods.—There are two principal methods of estimating uncollectible customers' accounts at the close of an accounting period:

1. All customers' balances may be appraised one by one, and the accounts deemed bad or very doubtful written off entirely or scaled down.
2. A blanket allowance may be made, based largely upon past experience with the accounts as a whole.

A combination of these two methods may also be employed.

Appraising Particular Accounts.—The first method may be employed to advantage in the case of concerns with relatively few but large credit customers. It has obvious objections where there are a large number of comparatively small balances.

In appraising the collectibility of the accounts, the main considerations to be kept in mind are as follows:

1. Length of time account has run.
2. Customer's practice with respect to discounts.
3. Trend of the account.
4. General character of dealings with customer.
5. His credit rating and similar data.
6. Special investigations and reports.

Usually the customer's balance is good, doubtful, or bad in its entirety. However, partial collection may occur in certain cases, particularly where one or more of the charges involved is in dispute.

Blanket Estimate.—The second method of estimating bad debt losses consists in taking a certain percentage of any one of the following:

1. Amount of credit sales.
2. Amount of total sales.
3. Amount of customers' accounts outstanding.

The first of these is to be recommended since the percentage of credit business which ordinarily proves to be uncollectible is the information desired. The second basis of figuring the percentage is substantially the same as the first and may be used where the cash sales are few. The third basis, customers' accounts outstanding, is considered to be the least satisfactory.

Aging of Accounts.—In connection with the estimate of bad debts, a classification and analysis of past-due accounts is advisable. For this purpose columnar sheets may be used, columns being headed, for example, as follows:

Less than 30 days past due
30-60 days past due
60-90 days past due, etc.

The longer the accounts are past due, the less the chance for collection. Hence, a greater percentage of the accounts 90 days past due must be written off than of those only 30 days past due. This grouping of accounts according to the number of days past due is known as "aging the accounts."

THE RETAIL SALES INVOICE

Checking Total Cash Tickets Against Cash Receipts—Analysis of Sales on Daily Sales Sheet—Recapitulation Sheet

Cash and Charge Tickets.—Practically all systems of handling sales require that at the time of the sale some record or memo of the transaction be made. In retail stores, the use by each salesman of a book of sales tickets with provision for duplicate or triplicate impression is very general, whether the sale be cash or charge. One copy is given to the customer or accompanies the goods when delivered. The other copy or copies are retained by the store for its own records. The cash and charge tickets are usually put up in separate books and a different color of paper is used for each. At the close of the day, the total cash tickets are checked against the cash received from cash sales, and the total charge tickets give a controlling figure for charges to customers. The total of the cash tickets plus that of the charge tickets gives the total credit to Sales.

Analysis of Sales.—These sales tickets are usually entered on a daily sales sheet provided with distributive columns for analysis according to departments or kinds of commodities. A recapitulation or summary giving the totals of each of these columns is made and posted to the ledger, while the customers ledger accounts may receive their charges direct from the sales ticket. This recapitulation really constitutes the sales journal record.

Whatever system is used, the sales ticket is the original record of the transaction and, therefore, valuable as evidence in case of dispute with the buyer. It should be filed away and kept until all danger of dispute is past.

POSTING THE CUSTOMERS LEDGER

Various Journals from Which Postings Are Made—Indicating Particular Invoices Being Paid—Posting Directly from Invoices

Journals from Which Entries Are Posted.—The postings to the individual accounts in the customers ledger are made mainly from the sales journal and the cash receipts journal. These postings are made daily in order that information regarding the status of the accounts may be available at all times. The charges to the accounts are made from the sales journal, while the credit entries are posted from the cash receipts journal. Credits for any returned sales or allowances on sales are made either from the general journal, or from a returned sales or allowances journal, if one is used. If a bookkeeper gives his entire attention to the customers ledger, he is not concerned with the offsetting entries—the credits to sales against the charges to customers' accounts, and the debits to cash against credits to customers, etc. Other bookkeepers take care of these entries.

Making the Posting.—The usual form of a charge entry in a customer's account is to insert the date, the number of the invoice, the terms in the explanation column, the sales journal folio, and the amount. (See form below.) The credit entries are similar except as to the cross-reference to the journal serving as the posting medium, which in this case will be either the cash receipts journal, the general journal, or the returned sales and allowances journal. The balance of the account will show the amount still due from customer.

Sometimes it is necessary to indicate what invoices are being paid, as the customer may dispute the charge for some other invoice, and refuse to pay it entirely or until certain ad-

NAME JOHN MAYERS & COMPANY — CARD No. 89

ADDRESS Wentworth Avenue, New York City — CREDIT LIMIT $2,000

TERMS

PROOF	DATE	REF.	FOLIO	CHARGES	✓	CREDITS	✓	BALANCE
	OCT 7	BAL						560.00 S
560.00	OCT 9	SOD	56	400.00				960.00 S
960.00	OCT 11	CSH	76			500.00		460.00 S
460.00	OCT 13	SOD	45	250.00				710.00 S
710.00	NOV 3	SOD	35	125.00				835.00 S

Customer's Account Showing Manner of Making Entries

justment is made in its amount. A customer has a legal right to say which invoice he is paying with a particular remittance. The rule to follow in all cases is, first, that any payment made without specifying the invoice to which it is applied, legally pays the invoices of the oldest date; and second, if payment of specified invoices is being made, as indicated by the customer's accompanying letter or notation on his voucher or other check, the payments or credits should be identified with the invoices or credits they are applicable to by a system of lettering. Thus, if a customer specifies that his remittance should be applied to the payment of a particular invoice, when the credit entry is posted, it should be lettered (a) and the previous debit entry for the invoice should likewise be lettered (a). The letters may be inserted in the amount columns to the left of the amounts, or in a separate narrow column immediately to the left of the amount column.

Postings Directly from Invoices.—Where the bills or invoices are voluminous and for small amounts, as for example, in the case of an electric light company in a community of some size, the sales journal may be dispensed with entirely so far as its serving as the posting medium for the customers ledger is concerned. The ledger will be posted directly from the carbon copies of the invoices, which ordinarily serve as the basis for the entry in the sales journal. In that case the sales journal merely serves the medium for making monthly or other summary postings to Accounts Receivable in the general ledger, or may be dispensed with entirely, the total of the duplicate invoices being entered in the general journal. When the sales journal is so used, it may assume a form entirely different from its usual form. It may be little more than an adding machine summary or recapitulation of the invoices, and therefore be unnecessary.

TURNOVER OF RECEIVABLES

Test of Efficiency in Managing Investment Tied Up in Customers' Accounts—Computing and Interpreting the Turnover

Definition.—The turnover of receivables expresses the relationship between the amount of customers' accounts or accounts receivable outstanding and the amount of sales. It is used to measure the relative economy and efficiency realized in handling the investment tied up in customers' accounts. The more rapid the turnover, the smaller are the capital requirements of the business so far as the particular investment represented by the outstanding receivables is concerned, and the greater is the efficiency shown in the collection of accounts.

Computation of Turnover.—The turnover of accounts receivable usually represents the number of days in which accounts receivable are collected. For example, if the average daily sales on account are $6,000 and the total accounts receivable outstanding at the end of the year are $200,000, then it means that the average number of days sales remain unpaid at the end of the year are 33. That is, the accounts are collected on the average about every 33 days. This time period is the turnover of accounts receivable—the number of days in which accounts receivable are turned over into cash.

Interpreting the Turnover.—To interpret turnover as a measure of collection efficiency, the credit terms must be taken into consideration. In the example given above, if the net credit terms are n/60 days, meaning payment within 60 days, then the collections are exceptionally good; the customers are paying their bills on the average of 33 days when they really could use 60 days. If, however, the sales terms are n/30 days, the collections are slightly slow, the customers paying their invoices on the average every 33 days, when the maximum credit term extended to them is 30 days.

The average daily sales are figured by dividing the total sales for the year by the number of business days in the year. If a concern operates on a six-day week, the total number of business days figured in a year is 313. If the firm is on a five-day week, the total number of business days in a year is 261.

PROVING THE CUSTOMERS LEDGER

Check Against General Ledger Controlling Account—Procedure in Proving—Use of Statements Mailed to Customers

Why Customers Ledger Does Not Balance.—At the end of every month or other period, when the sales journal, the cash receipts journal, the sales returns and allowances journal, the general, and other journals are closed and posted, and the summary entries are made in the Accounts Receivable account on the general ledger, the customers ledger is proved in order to ascertain whether or not the postings made to it daily throughout the period are correct. This cannot be done by taking a trial balance of the customers ledger, since that ledger does not balance. The individual customers' accounts in it have practically all debit balances. Only where the customer has made a prepayment, or has received credit for returned goods or an allowance after he has paid the invoice amount in full, and in other like instances, will his account have a credit balance.

Schedule of Customers' Accounts.—The method of proving the customers ledger is by comparing the sum of the debit balances in the customers' accounts, less any credit balances, with the balance of Accounts Receivable control account in the general ledger. The procedure in making this proof is to draw up on conveniently ruled paper a schedule or list of the balances in the customers ledger. If there are any credit balances, these can be grouped separately below the schedule of debit balances and subtracted from the total of the latter. If the credit balances occur frequently, a separate column may be provided in which to enter them. Such a schedule will appear as follows:

SCHEDULE OF CUSTOMERS' ACCOUNTS

July 31, 19–

	Debit	Credit
T. R. Smith..................................	$ 85.69	
M. L. Jones..................................		$25.62
S. T. Taylor..................................	169.72	
J. R. Frank..................................	79.82	
Total balances........................	$335.23	$25.62
Net Debit Balance, as per Controlling Account	$309.61	

Proof Against Accounts Receivable on General Ledger.—The net debit balance of all the customers' accounts as shown by the schedule should equal the balance of Accounts Receivable on the general ledger, the controlling account. This is because the postings to the customers ledger and to the controlling account were made from the same sources, the several journals, the only difference being that in the case of the customers ledger, the items on the journals were posted individually day by day, while in the case of the controlling account on the general ledger, the items were posted in monthly or other periodical totals. If there is a discrepancy between the final net debit balance shown on the schedule of customers' accounts and the balance of the controlling account, an error has been made in posting the individual accounts in the customers ledger, or in summarizing and posting the journals to Accounts Receivable on the general ledger.

The foregoing method can be used only to prove the correctness of the posting. It will not prove the correctness of the original entries made in the journals. The check against errors in the latter is in sending periodical statements of account to customers for their examination. Nor will it detect errors of posting to the wrong individual's account. It merely proves that the total of the individual debit postings equal the total of the summary entry.

ACCOUNTS RECEIVABLE ON THE GENERAL LEDGER

Advantages of the Summary or Controlling Account—Journals from Which Postings Are Made—How Entries Are Made

Reasons for Accounts Receivable on the General Ledger.—Where the customers' accounts are kept in a separate customers ledger instead of in the general ledger, it is necessary to open and conduct a summary account on the general ledger which will reflect the state of the customers' accounts as a whole. There are several reasons, some quite obvious, for keeping such a summary account.

First, this account makes the general ledger complete in itself so that it may be closed without reference to the customers ledger. This closing permits the determination of the profits for the period in question.

Second, when completely posted, accounts receivable balance on the general ledger shows at a glance the amount of money tied up in customers' accounts—always a valuable item of information for the management of the business.

Third, the postings to accounts receivable on the general ledger account are made by methods independent of the postings to the individual accounts in the customers ledger. It therefore serves as a check on the accuracy of the entries in the customers ledger. The customers ledger is "proved" against that balance. The general ledger account serves as a "control" for the customers ledger and therefore belongs to the group of accounts known as controlling accounts, which verify subsidiary ledgers by controlling them.

Sources of the Postings.—The postings to Accounts Receivable account on the general ledger are made weekly or monthly, whenever the sales and cash journals are totaled and ruled off. The postings are made from the following sources:

Debits:

Sales Journal—the total of the amounts column.

Credits:

Cash Receipts Book—the total of the Accounts Receivable column.

Returned Sales and Allowances Journal—the total of the amounts column.

General Journal—total of the Notes Receivable column, showing the amount of notes received from customers.

In a large accounting office, with a separate bookkeeper in charge of the general ledger, the total amounts from the several journals will be received by him on a memorandum from the clerks in charge of the journals. Upon receipt of the memorandum, he will make the postings to Accounts Receivable, which will then appear as shown below:

Accounts Receivable

19—						19—					
June	30	1680	S2	5,840	00	June	30		CR2	2,550	00
									J1	1,500	00
		5840							RS2	110	00
		4160								4160	
		1680									

From this it will be seen that the account has been charged with the total of the month's sales to customers, amounting to $5,840 from the sales journal (S); and has been credited with $2,550, the total of the payments made by customers during the month, from the cash receipts journal (CR), and $1,500, the total of notes received from customers in payment of their accounts as shown by Notes Receivable column in the general journal (J), and $110, the total of returned sales or allowances made during the same month, from the returned sales and allowances journal (RS).

When the general ledger bookkeeper has completed the postings, he strikes a balance, which he enters on the debit side in small figures in pencil as shown in the account given above. This balance must agree with the total of the balances of the individual accounts in the customers ledger. At the end of the next month similar postings are made, with no attempt to divide one month's postings from those of the month following. The general ledger, however, may be ruled so as to provide a separate column in which to enter the balance of each account.

CUSTOMERS LEDGER—FORM

Operation of a Loose-leaf Ledger—The "Transfer Ledger"—Controlling Accounts for Several Divisions of Customers Ledger

Bound and Loose-leaf Ledgers.—In a business selling to numerous customers, the individual accounts are recorded in a separate ledger devoted solely to this purpose, which is known as the customers or accounts receivable or sales ledger. In the general ledger there is then only one or several general or controlling Accounts Receivable accounts, the entries in which are made in monthly totals from the sales journal, the cash receipts journal, the returned sales and purchases, general and other journals. One purpose of this general account is to show the company's general status as regards the aggregate of accounts receivable from customers.

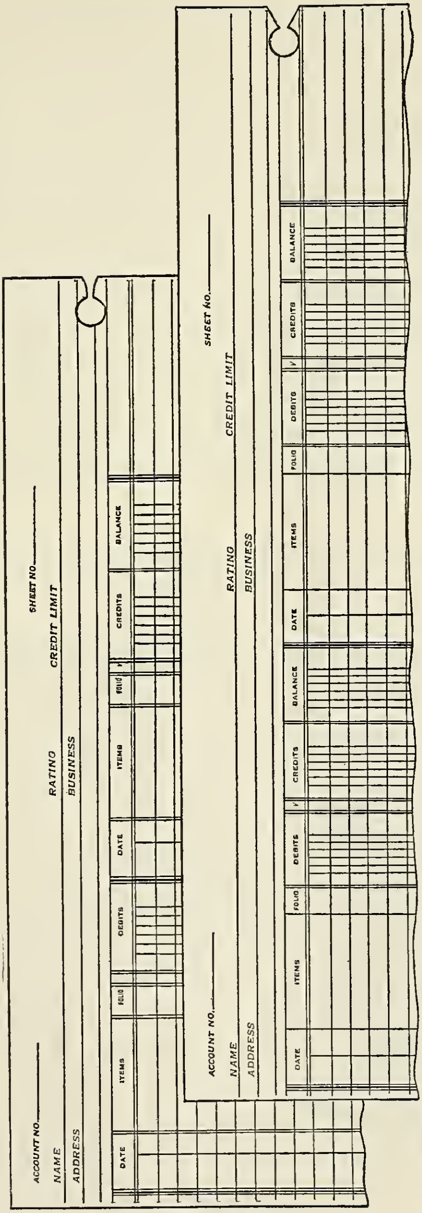
Although some organizations still use the old-fashioned permanently bound ledgers for keeping individual customers' accounts, the more common method today is to use loose-leaf ledgers, consisting of sheets, one for each account or customer, placed in a binder, or file cabinet, in alphabetical order. The flexibility of the ledger in this form permits the withdrawing of sheets as accounts are closed or sheets are filled up and the insertion of new sheets in their proper alphabetical place as new accounts are opened or new sheets for old accounts are inserted. The sheets are not numbered usually but are kept in alphabetical order according to the names of the customers. The account of a particular customer can, therefore, be readily found without having to consult an index in the front of a bound ledger, or sales journal, for the ledger folio number.

As a matter of fact, there is then no need of entering the ledger folio in the sales journal, and the only purpose served by the ledger folio column in that journal is to indicate by check mark that the posting has been made. Sometimes customers' accounts are kept on large cards in trays; then the customers ledger consists of a card file tabbed and arranged alphabetically. Many banks, for example, find this card system very convenient, especially with the use of posting machines.

It is desirable to retain for a certain time sheets filled up and no longer of immediate use, and sheets of closed accounts. This is frequently done by placing them in a separate binder, called "transfer ledger."

Division of Ledger.—Where the customers ledger is used, it is in charge of at least one clerk. If two or more clerks are necessary because of many transactions with numerous customers, the ledger is divided alphabetically into several sections, and a bookkeeper placed in charge of each section. The division is made by placing all accounts with names beginning, say, with A to M in one ledger, and those with N to Z in another. Further subdivisions may also be made if necessary. Such division necessitates having a separate summary account for each customers ledger on the general ledger and also separate columns for each group of customers in the sales journal and the cash receipts journal.

Ruling of Customers Ledger.—The customer's account is ruled in various ways, according to the needs it is designed to serve. One method is the standard form of ledger account, with the same columns used in both the debit and the credit sections of the account. This, however, has usually been abandoned for other forms, with a column or columns to show currently the balance of the account. Illustration (a) presents a form which is similar to the standard form of ledger account, except that a column is added to show the balance of the account after each debit or credit entry, or monthly. Form (b) has a single set of columns for both debit and credit items alongside of each other. The balance will ordinarily be a debit one, but if it should happen to be a credit, it should be indicated by writing *Cr.* next to the figure,



(a) Customer's Account With Column for Balance
(b) Customer's Account with a Single Explanation and Certain Other Columns

or by writing the balance in red ink. When customers' accounts frequently have credit balances, the balance column may be divided into a debit and a credit section. Where the machine method of making postings to the customers ledger is used, the ledger will appear in a form as shown on page 206.

It will be noted that space is reserved at the top of each form for the insertion of the name, address, and business of the customer, his credit rating as reported by a commercial agency, such as Dun & Bradstreet's, and the credit limit, or the maximum balance which the customer may owe the concern. It is one of the duties of the bookkeeper or bookkeepers in charge of the customers ledger to watch the balance of each account in relation to the credit limit, and if the latter is exceeded, to report the fact immediately to the credit department.

ACCOUNTS RECEIVABLE—ALLOWANCE FOR BAD DEBTS

Bad Debt Loss as an Expense—Entries for Bad Debt Losses Recording Recovery of Charged Off Accounts

Reason for Allowance.—Every business which deals with the general trade on a credit basis suffers losses from uncollectible accounts. These losses are an expense of carrying on the business and are shown on the profit and loss statement under selling or financial management expense. At the end of each accounting period, the probable loss from uncollectible accounts is estimated. If the probable loss is estimated at $500, the following adjusting entry, preliminary to closing the books, is made:

Allowance for Bad Debts............................	$500.00	
To—Reserve for Bad Debts..................		$500.00
To record estimated uncollectible accounts.		

Allowance for Bad Debts, being an expense account, is closed out to Profit and Loss account when the books are closed.

Relation of Reserve for Bad Debts to Accounts Receivable.—The credit entry made in the Reserve for Bad Debts account is in reality for the purpose of reducing the debit balance in Accounts Receivable in the general ledger. Instead of entering the credit for the bad debt loss directly in Accounts Receivable, a separate account is opened for the purpose, because it is desirable to have a separate record of the amount of the estimated bad debt losses. But the two accounts are virtually one and should always be considered together. On the balance sheet, the Reserve for Bad Debts is preferably shown as a deduction from the total of Accounts Receivable. The Reserve for Bad Debts may be shown on the liability side of the balance sheet under a heading called Reserves. The former method is the one generally approved, thus:

Accounts Receivable	$20,000.00	
Less—Reserve for Bad Debts....................	500.00	
		$19,500.00

The $19,500 represents the company's estimate of the cash which will be realized from customers' balances when these accounts are paid.

Charging Actual Losses to Reserve for Bad Debts.—It will be noted that no entries are made for bad debt losses in the individual customers' accounts, since it is not known as yet which accounts will prove to be uncollectible. When an account becomes uncollectible, the charge is not to Profit and Loss, since the charge for estimated bad debt losses made to Profit and Loss at the end of the preceding accounting period is supposed to cover this uncollectible account. Instead the charge is to the Reserve for Bad Debts and the credit to the customer's account, as follows:

February 10, 19–

Reserve for Bad Debts...............................	$310.00	
Accounts Receivable (Jones & Co.)............		$310.00
Uncollectible account charged off.		

The entry is made through the general journal, and when it is posted, not only must the customer's account, Jones & Co., be credited with an appropriate explanation, as "written off," or "charged off," to show that the credit is merely to close the account, but also Accounts Receivable in the general ledger, in order that the latter account may be in agreement with the customers ledger. When the uncollectible account is closed, it is ruled off in the usual manner.

If an account which has been charged off is nevertheless subsequently paid, a proper explanation should be made in the cash receipts book, and in posting the item a separate account on the general ledger, entitled "Bad Debts Recovered," may be credited with the amount of the payment, the offsetting debit being, of course, to Cash. In the profit and loss statement, the balance of this account may be included under the heading of "Other Income" or "Financial Management Income." At the same time, when the bad debt is recovered, an entry should be made, with an appropriate explanation, immediately below the former customer's closed account, and the account ruled off again. Another method sometimes followed in the case of a corporation is to credit the payment of charged-off accounts directly to the Surplus account.

Adjustment of Allowance for Bad Debts.—The charges to the Reserve for Bad Debts will be made throughout the ensuing accounting period as customers' accounts are definitely determined to be uncollectible. At the end of the period, if there is a sizable credit balance remaining in Reserve for Bad Debts, it is an indication that the estimate or allowance for bad debts previously made was excessive, and hence may be correspondingly reduced for the next period. On the other hand, if the actual losses during the period have exceeded the allowances, so that the Reserve for Bad Debts has a debit balance, the allowance for the next period must be increased.

THE OUT-FREIGHT ACCOUNT

Handling of Prepaid Freight on the Sales Journal—On the Cash Disbursements Journal

Payment of Freight Charge.—It is the more usual practice for the customer to pay the freight or delivery charge on shipments. Sometimes the vendor pays, and in that case the freight is either included in the quoted sales price, or by agreement with the customer it is prepaid by the vendor and included in the invoice as a separate item.

Bookkeeping Entries.—In the case of prepaid freight to be charged to the customer, the bookkeeping entries to record the transactions involved are usually made in accordance with the following routine. When the freight bill is paid, it will be recorded in the cash disbursements journal as a charge to Out-Freight account. The charge to the customer both for the prepaid freight and for the goods bought will be made in the sales journal. This will introduce into the sales journal an item which is not a sale of merchandise and which should not, therefore, be credited to Merchandise Sales account. Where many prepaid freight transactions are to be recorded, it is best to provide in the sales journal an additional column headed Out-Freight. The total charge to the customer will be entered in the Total column, from which the portion covering the charge for the goods sold will be extended into the Merchandise Sales column, while the charge for prepaid freight will be entered in the Out-Freight column. At the time of summarizing the sales journal, two credits will be set up, the one to Merchandise Sales account for the total of its column, and the other to Out-Freight account for the total of its column.

The Out-Freight account in the ledger thus receives its debits from the cash disbursements journal and its credits from the sales journal. If all out-freight is chargeable to the customer, the Out-Freight account will ultimately balance. In the event that there is a debit balance in the account, it represents freight on customers' orders, the cost of which is borne by the vendor.

C. O. D. SHIPMENTS

Various Methods of Making Collections—Drawing of Sight Draft on Consignee—Order Bill of Lading

Express Company Collections.—C. O. D. shipments are handled through the agency of an express company, the post-office, or a bank. Express companies accept shipments which are to be paid for upon delivery, agreeing to collect and remit the amount of the invoice to the shipper, or less collection and remittance charges, according to the instructions given by the shipper. This method of shipping sometimes gives the purchaser the privilege of examination before acceptance. It is used with customers who are unknown to the shipper or with those whose credit is doubtful.

Collection by Parcel Post.—When the parcel post service is used for shipping goods C. O. D., the post-office makes the collection for the shipper. The customer pays for the goods by postal money order. The shipper must, of course, always prepay the postage, although this may by agreement become a charge against the customer.

Collection by Draft.—When a bank is made the shipper's agent to collect on delivery, a sight draft is drawn on the consignee and sent to the bank along with a special C. O. D. bill of lading called the "order bill of lading." (See page 222.) This original C. O. D. bill of lading together with the attached draft is sent by the bank to its correspondent located in the same city as the consignee. The correspondent bank presents the draft to the consignee for payment, and thereupon delivers the special bill of lading to him. The shipper's order to the railroad provides that the goods are to be delivered only upon presentation by the consignee of this special bill of lading. In the use of the order bill of lading, it is customary for the original copy to show the goods shipped to the order of the shipper himself. This copy, indorsed by the shipper, and the attached draft are the documents used by the bank in making the collection.

SHIPPING GOODS—THE BILL OF LADING

Order and Straight Bills of Lading—Preparation of Ladings in Triplicate—Use Made of Several Copies

Definition and Form.—A shipment of goods by rail or steamship is evidenced always by a "bill of lading," a contract under which the railroad or steamship company accepts freight for carriage, defines its liabilities as a transportation company or warehouseman for the safe transportation and custody, and states its duties and those of the shipper. The standard content of the bill of lading is prescribed by the Interstate Commerce Commission, which regulates many phases of the railroads' business, although any additions to it not in conflict with the standard content are permitted. If the shipper so desires, he may have bills of lading printed to conform in size with his own files, instead of using those furnished by the railroad. There are two standard forms—the "straight" bill of lading, which is made out simply to the consignee and is therefore not transferable or negotiable; and the "order" bill of lading (illustrated herein), which is made out to the consignee "or order" and is therefore negotiable by indorsement. Banks which make advances against shipment of goods usually insist that the bill of lading be of the "order" type, so that it may be indorsed, giving them full control of the shipment until it is released in accordance with the terms of the loan.

Uniform Domestic Order Bill of Lading Adopted by Carriers in Official, Southern and Western Classification Territories, March 15, 1922

UNIFORM ORDER BILL OF LADING
(PRESCRIBED BY THE INTERSTATE COMMERCE COMMISSION)
ORIGINAL

Shipper's No.______
Agent's No.______

Merchants and Miners Transportation Company

RECEIVED, subject to the classifications and tariffs in effect on the date of the issue of this Bill of Lading,

at__________________, 19

from__________________

the property described below, in apparent good order, except as noted (contents and condition of contents of packages unknown), marked, consigned, and destined as indicated below, which said company (the word company being understood throughout this contract as meaning any person or corporation in possession of the property under the contract) agrees to carry to its usual place of delivery at said destination, if on its own road or its own water line, otherwise to deliver to another carrier on the route to said destination. It is mutually agreed, as to each carrier of all or any of said property over all or any portion of said route to destination, and as to each party at any time interested in all or any of said property, that every service to be performed hereunder shall be subject to all the conditions not prohibited by law, whether printed or written, herein contained, which are hereby agreed to by the shipper and accepted for himself and his assigns.

The surrender of the Original ORDER Bill of Lading properly indorsed shall be required before the delivery of the property. Inspection of property covered by the bill of lading will not be permitted unless provided by law or unless permission is indorsed on the original bill of lading or given in writing by the shipper.

(Mail or street address of consignee—For purposes of notification only.)

Consigned to **ORDER OF**__________________
Destination__________ State of__________ County of__________
Notify__________________
At__________ State of__________ County of__________
Route__________________
__________ (Delivering carrier) Car Initial__________ Car No.__________

No. Packages	DESCRIPTION OF ARTICLES, SPECIAL MARKS, AND EXCEPTIONS	*WEIGHT (Subject to Correction)	CLASS OR RATE	Check Column

If this shipment is to be delivered to the consignee without recourse on the consignor, the consignor shall sign the following statement:

The carrier shall not make delivery of this shipment without payment of freight and all other lawful charges.

__________ (Signature of consignor.)

If charges are to be prepaid, write or stamp here, "To be Prepaid."

Received $__________ to apply in prepayment of the charges on the property described hereon.

__________ *Agent or Cashier.*

Per__________
(The signature here acknowledges only the amount prepaid.)

Charges advanced:

$__________

* If the shipment moves between two ports by a carrier by water, the law requires that the bill of lading shall state whether it is "carrier's or shipper's weight."

NOTE.—Where the rate is dependent on value, shippers are required to state specifically in writing the agreed or declared value of the property.

The agreed or declared value of the property is hereby specifically stated by the shipper to be not exceeding__________ per__________

__________ *Shipper.* __________ *Agent.*

Per__________ Per__________

*Permanent post-office address of shipper*__________

An Order Bill of Lading

Copies of Bill of Lading.—The bill of lading is always made out in triplicate, the original and the two copies being identical except as to titles and signatures. The original is signed by the shipper and the railway agent, and constitutes the shipper's receipt for the goods delivered to the railroad. The second copy, called the "shipping order," is signed by the shipper only. It is his order to the railroad to ship the goods, and is held by the railroad as evidence of its authority. The third copy or memo is an exact duplicate of the orginal. Like the first copy, it is signed by the shipper and the agent, and is held by the shipper as a duplicate receipt. Sometimes it is forwarded with the invoice to the customer, but otherwise should be filed by the shipper with the original bill of lading. In case of claim against the railroad for loss or damage to goods in transit, the original bill of lading is required as evidence and should therefore always be kept in the shipper's possession.

NOTES RECEIVABLE ACCOUNT

Value at Which Interest or Non-Interest-Bearing Notes Are Recorded—Custody of Notes in Safe—Identifying Credits with Debits in the Account

Receipt of Notes.—The average business is seldom in receipt of a promissory note. Every now and then, however, a customer pays his account by giving his note for the balance due. In that case he pays one form of debt by means of another. The creditor may be glad to have the collection of a debt in the form of a promissory note since its collection is more easily enforced at law than the collection of an open account. The business may also receive a note to evidence a loan of money it has made. In special transactions, such as the sale of real estate, the buyer may give his note secured by a mortgage, as part of the purchase price. However, in some lines of business, it is customary for the firm or company to take notes from its buyers.

Recording of Notes.—Whether notes are interest-bearing or non-interest-bearing, they are always recorded at face value. When a customer delivers his note in payment of his account, the entry made is a debit to Notes Receivable and a credit to the customer's account. The notes of all makers are recorded in the one account, Notes Receivable, and unless a note register or journal (see page 242) is used, the entry is made through the general journal. A full explanation of each note recorded is usually given in the description column of the account. The notes themselves are placed in alphabetical order, according to the name of the maker, in a separate file or portfolio in the safe. The total amount of the notes in the file should equal the balance of the Notes Receivable account. When a note is taken out of the file, discounted or forwarded to a bank for collection, a memorandum explaining its absence from the file should be left.

When a note is paid, the receipt of the payment is entered in the cash receipts journal, from which a credit posting is made to the Notes Receivable account. If the note is interest-bearing, there will be a credit also to Interest Income. In making the posting, the maker's name is entered in the explanation column of the ledger account. In addition, in order that the account may show readily which notes have been paid, the credits are identified with the debits by means of cross-reference letters set against the corresponding amounts on each side of the account, as follows:

Notes Receivable

19—						19—					
Aug.	6	T. S. Taylor—90 da.	J 3	a500	–	Sept.	7	F. L. Smith—30 da.	CR1	b300	–
	8	F. L. Smith —30 "	J 3	b300	–						

The letter (b) appearing against the $300 amount on opposite sides of the account shows at a glance that F. L. Smith has paid his 30-day note of August 8 on September 7. This system of cross-reference between the debit and credit entries in the account is especially advantageous where the entries are fairly numerous.

RECORDING A DISHONORED NOTE

Entries on Payee's and Maker's Books—Methods of Making Entries—Interest and Protest Fees

Charging Maker's Open Account.—When the maker of a note fails to pay it, it is protested. The accounting procedure usually followed is to charge the note to the maker's open account, at the same time crediting Notes Receivable. The charge should include not only the face of the note, but also interest receivable to the maturity date, if the note is interest-bearing, and also the protest fees which have been paid, as the maker of the note is liable for these also. Income is credited for the amount of the interest receivable, and cash for the protest fees. As the payment of the note and interest is in doubt, a liberal allowance should be included for this particular item, in the reserve for bad debts set up at the end of a fiscal period.

Setting Up Notes Past Due Account.—Another method of handling a dishonored note is to charge it to a Notes Past Due account, instead of to the maker's open account. The journal entry will then be as follows:

Notes Past Due	$1,032.50	
Notes Receivable		$1,000.00
Interest Receivable		30.00
Protest Fees (or Cash)		2.50
G. T. Moore's 6-mo. note dishonored and protested 7/7.		

On Maker's Books.—The maker of the dishonored note need not make any entry to record its non-payment, but he should record the liability due to unpaid interest by debiting Interest Expense and crediting Interest Payable.

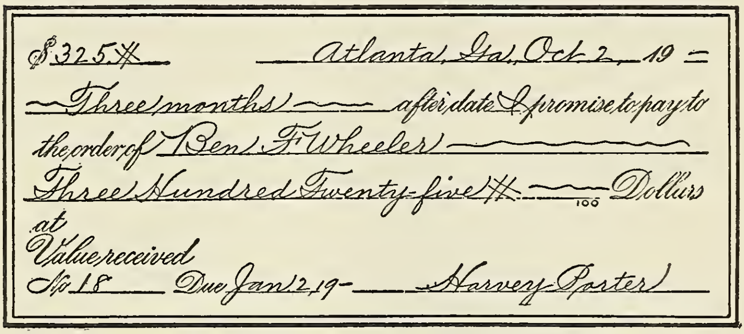
PROMISSORY NOTE

Parties to a Promissory Note—Several Forms of Negotiability—Interest and Non-Interest-Bearing Notes

Promissory Note Defined.—A promissory note is a written instrument by means of which the party who signs it agrees to pay another party a stated sum of money on demand or on a certain future date, either with or without interest. The one who makes the promise and signs the note is called the maker or drawer of the note, while the party in whose favor the note is drawn, that is, to whom the note is payable, is the payee. One in possession of the note, who may be some one other than the payee if the note is negotiated, is the holder of the note.

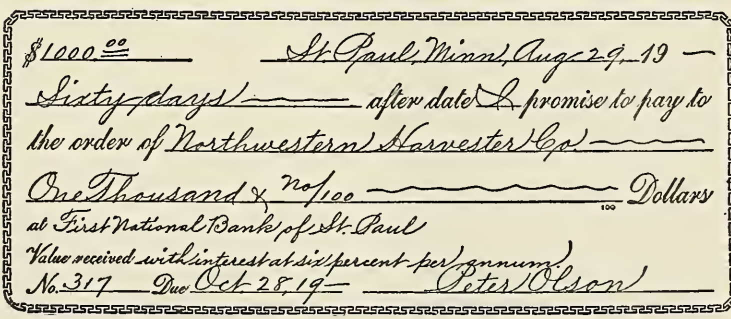
Maturity of Note.—The period for which a promissory note runs is known as its maturity. The note may be a demand note, in which case it is payable at any time upon the demand of the holder. It may, on the other hand, be drawn to run for a stated period, such as two months, three months, 60 or 90 days, from its date. Notes may also be drawn as payable on a stated future date, as "June 28, 19–."

Negotiability of Note.—Notes are drawn in various forms. A note may be drawn payable to John Smith. In this case it is payable at maturity only to John Smith. Or it may be drawn to "John Smith's order," or to "the order of John Smith." The note is then negotiable or transferable, and may pass through the hands of a number of holders; but upon each transfer the previous holder must indorse or sign his name on the back of the note. Upon maturity, the note is payable to the one then holding it, who presents it to the maker for payment. Sometimes a note contains the words "or bearer" after the payee's name, as "John Smith, or bearer." Such a note is negotiable or transferable by mere delivery, and its indorsement by the successive holders is not required.



$325 xx/100 — Atlanta, Ga., Oct. 2, 19 —
Three months — after date I promise to pay to
the order of Ben F. Wheeler
Three Hundred Twenty-five xx/100 Dollars
at
Value received
No. 18 Due Jan. 2, 19— Harvey Porter

(a) Promissory Note Without Interest



$1000.00 St. Paul, Minn., Aug. 29, 19 —
Sixty days — after date I promise to pay to
the order of Northwestern Harvester Co.
One Thousand & no/100 Dollars
at First National Bank of St. Paul
Value received with interest at six percent per annum.
No. 317 Due Oct. 28, 19— Peter Olson

(b) Promissory Note With Interest

Interest Payment.—With respect to interest payment, notes are of two classes. One type of note is drawn for a flat sum and does not bear interest. An example of such non-interest-bearing note is shown in form (a). The other type is one which bears interest for the time it runs at the per annum rate mentioned in the note, as illustrated in form (b).

The Note Given in Settlement of Open Account.—The promissory note often serves as an intermediate step in the settlement of a debt. Debts are usually settled by payment of money, but at times a formal written promise to pay money postpones to a later date the payment of a debt, such as an open account. Since this formal promise can be held until maturity when its value in money will be received, or can be transferred to a creditor to settle a debt and so serve in place of money, or can usually be sold at any time to a banker, the owner of the promise can thus convert it into money quite readily. The open account cannot be converted into money or transferred before its due date as easily as a note.

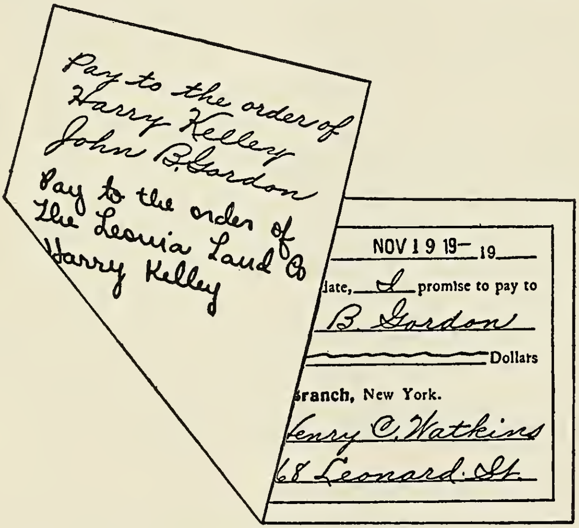
INDORSEMENT OF NOTES

Various Forms of Indorsement—Responsibility of Indorser—The Negotiation of a Note

Negotiation of Note.—When a note is payable "to the order of" the payee, it is negotiable or transferable by indorsement and delivery of the note. Title to the note does not pass to the new holder, unless the note is, first, indorsed by the previous holder, and second, is delivered to him. With each transfer the note must receive the indorsement, that is, the signature, of the previous holder.

Successive Indorsements.—Standard practice is to write the indorsement across the left end of the note on the reverse side (see illustration below). There may be any number of indorsements. If there is not sufficient space on the back of the note for all the indorsements, a strip of paper, called an "allonge," may be attached to the note.

A note may be transferred at any time before its due date. Transfer may even be made after that date, but such a transfer does not carry with it the guaranty of the indorsers as to payment. If there are five indorsements on a note, the sixth party, being the holder of the note, is the one to whom payment is to be made, and if such payment is not made by the maker at maturity, the sixth party must look to the last indorser (that is, the fifth party) for payment, because in transferring the note to him this party guaranteed its payment. The fifth party may in turn look to the fourth party for payment for the same reason. Similarly, the fourth party may



Note Showing Indorsements

hold the third; the third, the second; and the second, the first. The first indorser is, of course, the original payee and must rest his claim for payment against the maker of the note who originally promised to pay.

The names "indorser" and "indorsee" are sometimes given respectively to the party making the indorsement and to the new payee named in the indorsement. Thus, in the indorsement, "Pay to the order of James Grover, (Signed) George Strong," George Strong is the indorser and James Grover the indorsee. If James Grover indorses the note over to Richard Jones, he becomes in turn the indorser and Jones the indorsee.

Forms of Indorsement.—A promissory note may be indorsed in three ways. These are:

1. The unqualified indorsement
2. The qualified indorsement
3. The restrictive indorsement

The unqualified indorsement may be made in either one of two ways. It may be made in blank by the signing of the payee's name with no other words added. This is called a blank indorsement, and since it does not name the new payee, its effect is to permit the collection of the note by any one into whose possession it may come. It has the same effect as the words "or bearer" on the face of the note.

An unqualified indorsement may also be made by designating the new payee. The customary phraseology of this full indorsement is as follows: "Pay to the order of James Grover," followed by the signature of the former payee, in this case, George Strong. The effect is to limit payment of the note to the stated payee or to his order, so that he may in turn order payment made to some one else.

Qualified Indorsement.—A qualified indorsement usually contains the words "without recourse" and may read: "Pay to the order of James Grover without recourse, George Strong." The effect of this indorsement is to free George Strong from liability for payment of the note in case the original maker should not pay it when due. Legally every indorser guarantees payment of the note to the new payee in accordance with the terms stated on its face. In the event that the maker does not pay, the indorser may be held liable for payment. It is only because of this guaranty that the note passes readily from hand to hand. The effect of the qualified indorsement is to free the indorser from this liability. He does guarantee, however, that the note is regular in all respects, namely, that there has been no fraud in drawing it, and that the signatures of all parties and indorsers are regular and not fraudulent.

Restrictive Indorsement.—The restrictive indorsement may restrict the new payee as to his use of the funds collected or may restrict payment to a designated party. The following are types of restrictive indorsements:

1. "Pay to the Merchants Bank for collection." This allows the Merchants Bank only to collect the note for George Strong, the funds collected to be turned over to Mr. Strong.
2. "Pay to the order of the Merchants Bank for deposit only." The effect of this is practically the same as the first form of restrictive indorsement, the Merchants Bank being appointed a collection agent for the payee, George Strong, the funds to be deposited to his credit in that bank.
3. "Pay to James Scott only." This indorsement restricts payment to James Scott and stops the negotiability of the note. Scott, however, may assign the note to another party by means of a separate written instrument.

PROTEST OF A DISHONORED NOTE

Need of Present Holder Giving Notice of Default—Waiver of Notice of Protest—How to Protest a Note

Dishonoring of Notes.—A note not paid by its maker at maturity is said to be dishonored, that is, the maker does not live up to or honor his formal contract. When a note is dishonored, in order to protect the holder's rights, it is customary to make what is called a protest.

Each successive holder of a note accepts the note on the condition of the guaranty by the previous holder of its payment. The holder of the note in whose possession it is dishonored will, therefore, look to the party from whom he received it for payment. That party will in turn look to the party from whom he received it, etc. In order, however, to compel payment by a previous holder, notice must be given him by the present holder, his agent, or by a notary. The law requires that this notice be given on the day following the day of dishonor. If the party to whom notice is to be sent has placed his address on the instrument, notice must be sent to that address; otherwise to his place of business or his residence. If in transferring title to the note, an indorser

New York, July 7, 19__

Please to take Notice, That a Promissory Note made by George T. Monroe

for Five hundred and no/100 Dollars

dated January 7, 19-

payable at at the maker's office, 44 Wall St., N. Y. City

endorsed by you, having been this day presented for payment which was duly demanded and refused, is **protested** for non-payment, and that the holder looks to you for the payment thereof.

Your obedient servant,

Ralph Stevens

Notary Public.

To Frank L. Parsons
293 Lawrence Street
Yonkers, New York

Notice of Dishonor

has signed it, using the words, "waiving notice of protest," such indorser can be held without giving him formal notice of protest within the customary one-day limit set for such notice. Unless, however, such notice is given to all other indorsers within the one-day limit, they are released from their guaranty and no action can be instituted against them for the collection of the note. The holder must, in this case, collect the note from the maker by legal process.

Protesting a Dishonored Note.—The procedure of formal protest is in general as follows. The holder of a dishonored note goes before a notary public and makes a sworn statement of all the facts in the case, chief of which are that he holds a note now due and payable by its maker, that presentation for payment has been made, that payment has been refused, or that presentation was impossible, because of inability to find the maker at his customary place of business or his residence. The notary enters these facts in his records, takes the note and himself attempts presentation for payment. If payment is still refused, the notary sends formal notices (see form above) to that effect to all the previous holders or indorsers whom it is desired to hold to their contracts of guaranty, if their addresses are known. If their addresses are not known, the notices are sent to the next previous holder who takes his and in turn sends them on to the holder from whom he received the note, etc., until in due course all notices of dishonor have been delivered to the proper parties. In this way each holder may collect from the next previous holder until the original payee is reached, who must look to the maker of the note for satisfaction.

DISHONORED DRAFTS

Protest for Non-Acceptance and Non-Payment—Treatment of Foreign and Domestic Drafts

Non-Acceptance of Draft.—Drafts are dishonored by non-acceptance and by non-payment. If the drawee refuses to accept a draft drawn on him, it is necessary, in the case of a foreign bill (drawn in one state and payable in another state or another country), to make formal protest in order to hold the drawer and any indorsers liable. Protest is not necessary in the case of a domestic or inland bill which is one drawn and payable in the same state. Since it is not necessary, in the case of time-after-date drafts (see page 78), to make presentation for acceptance until maturity, the draft may bear the indorsements of several parties to whom it has been transferred. To hold them, formal protest must be made. The procedure of protest for non-acceptance is the same as in the case of notes for non-payment at maturity (see page 231).

Non-Payment of Draft.—An accepted draft becomes to all intents and purposes a promissory note. It constitutes the drawee's promise to pay. The liability of the drawer corresponds with that of the first indorser of a promissory note. Regular indorsers on a draft take rank after the drawer. Protest for non-payment of an accepted draft is, of course, just as necessary as for the non-payment of a note and the procedure is identical. Protest for non-acceptance should be carefully distinguished from protest for non-payment.

THE COLLECTION DRAFT

How Draft Is Drawn—Method of Collection—Legal Effect of Dishonor of Draft—Accepted by Banks for Collection Only

Form of Draft.—The draft is often used for the collection of past-due accounts. Sales are frequently made under a contract somewhat as follows: 2% 10 days, net 30 (2/10, n/30), subject to sight draft without notice. This means that the seller of the goods will draw a sight draft on the customer if payment is not made at the time agreed upon. Such a draft is usually made payable to the drawer's bank or to "Ourselves," the drawer and the payee being one and the same party in the latter case. The draft is usually handled through the drawer's bank, which will send it either direct to the drawee or to its correspondent bank at the drawee's address for presentation and collection. The form of the draft is illustrated below.

Legal Status of Draft.—This draft, being nothing but a request, has no stronger legal status than any other request for payment of a debt. The dishonoring of such a request by the drawee, however, reflects on his credit standing among the banks in his own community. On the other hand, it may happen that the drawee has a greater claim against the drawer because of unsatisfactory goods or past claims not satisfactorily settled. In such a case, the drawee's refusal to pay should not discredit him. The collection draft has become so

NO PROTEST
Take this off before Presenting

New York, October 21, 19__

$*125.40*

Pay to the

Order of BLANK TRUST COMPANY

One Hundred Twenty-Five & 40/100 *Dollars*

Value received and charge the same to account of

To *Kean & Dennis*
No. *45 Wichita, Kansas* *Rogers, Hughes & King*

Collection Draft

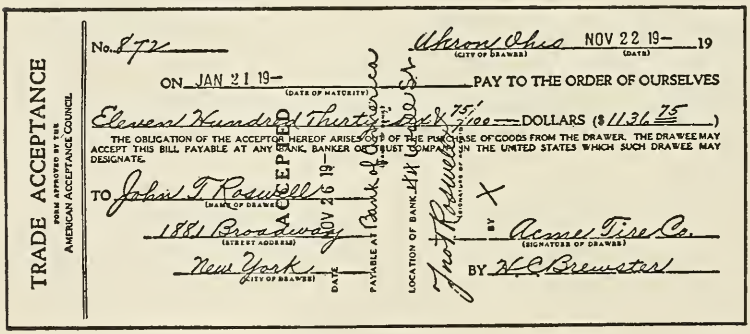
common that debtors who know its purpose and legal status are inclined to pay no more attention to it than to a letter from the creditor requesting payment. Collection drafts frequently carry on a perforated margin at one end the words, "No protest, tear this off before presenting." This is an instruction to the bank that the expenses of protesting the draft are not to be incurred in the event of the drawee's refusal to accept. The perforated slip should be torn off before presentation to the drawee, as it is an instruction to the bank and not to the drawee.

Collection drafts are never accepted by the bank as deposits to the drawer's account. They are accepted for collection only and will be credited when and if collection is made.

THE TRADE ACCEPTANCE

Purpose of Trade Acceptance—Its Definition by Federal Reserve Board—As Distinguished from Ordinary Draft

Form of the Trade Acceptance.—A form of draft which is used in trade is called the trade acceptance to distinguish it from the financial draft, whose purpose is merely the transfer of funds without regard to their source or to the transactions out of which the debtor and creditor relationship arises. The purpose of the trade acceptance is largely to do away with the open account when goods are purchased. Thus,


TRADE ACCEPTANCE
FORM APPROVED BY THE AMERICAN ACCEPTANCE COUNCIL
No. 872 Akron, Ohio NOV 22 19— 19
(CITY OF DRAWER) (DATE)
ON JAN 21 19— PAY TO THE ORDER OF OURSELVES
(DATE OF MATURITY)
Eleven Hundred Thirty-Six & 75/100 DOLLARS ($1136 75/100)
THE OBLIGATION OF THE ACCEPTOR HEREOF ARISES OUT OF THE PURCHASE OF GOODS FROM THE DRAWER. THE DRAWEE MAY ACCEPT THIS BILL PAYABLE AT ANY BANK, BANKER OR TRUST COMPANY IN THE UNITED STATES WHICH SUCH DRAWEE MAY DESIGNATE.
TO John T. Roswell (NAME OF DRAWEE)
1881 Broadway (STREET ADDRESS)
New York (CITY OF DRAWEE)
ACCEPTED
DATE NOV 26 19—
PAYABLE AT Bank of America
LOCATION OF BANK 4th Ave. St.
Jno. T. Roswell (SIGNATURE OF ACCEPTOR)
X
Acme Tire Co. (SIGNATURE OF DRAWER)
BY H. C. Brewster

Trade Acceptance

when such a transaction takes place, instead of setting up a charge against the customer on the seller's books, the use of a time draft, called in this case a "trade acceptance," will bring about a charge to Notes Receivable or Trade Acceptances Receivable, instead of to the customer's account. The Federal Reserve Board defines a trade acceptance as a "bill of exchange drawn by the seller on the purchaser of goods sold, and accepted by such purchaser." A form of the trade acceptance is shown above.

Distinguished from Ordinary Draft.—The trade acceptance is practically identical with the draft, the chief difference being the inclusion of a statement on its face to the effect that it has arisen out of an ordinary commercial transaction, usually the purchase of goods. It is drawn at the time goods are sold and takes the place of an open account with the customer. The ordinary draft is drawn at any time and has no necessary relationship to a purchase of goods, although the debtor and creditor relations between the parties may originally have arisen out of a purchase and sale of goods. The ordinary draft usually indicates financial or credit difficulties, but in the case of the trade acceptance, the drawer is also the payee, since he has sold goods and in drawing the draft makes the order for payment to himself. The drawee is then the customer. The trade acceptance is a recognized business paper and does not reflect on the credit of the acceptor. Hence, the words on its face describing how it arose. The trade acceptance enables the seller of the goods to realize cash immediately by discounting the acceptance at his bank.

PAYMENT OF A NOTE

Payment When No Place Specified—Making Formal Demand of Payment—When Demand May Be Made

Place of Payment.—When a note falls due, it must be presented for payment. The place may be specified on the face of the note, in which case it is payable only at that place. The place may be the maker's office or residence, his bank, or any other place mutually agreed upon. If the maker's bank is named, this constitutes an order on the bank to pay the note when due and charge the amount to the maker's bank account, unless an order to refuse payment has been left at the bank by the maker. If no place is specified, presentation at the maker's place of business, or at his residence, is all that is required of the holder of the note.

Presentation for Payment.—What constitutes "presentation for payment" is sometimes a nice question at law. Where a note is made payable at a given place, it must be presented at that place to the maker of the note, or, if he is absent, to any person in charge. If the maker is no longer living, the presentation should be made to the executor or administrator of his estate. The holder must show the note and demand payment. If payment is made, the note must be surrendered to the maker, and is usually marked "Paid" with the date of payment. As to time of presentation, the note must be presented on the day stated or determined to be the maturity date of the instrument. A note falling due on Sunday or a legal holiday is payable on the next business day. A note falling due on Saturday, where Saturday is a half-holiday, must be presented by 12 o'clock noon or on the succeeding Monday.

Presentation must be made at a reasonable hour on the business day. This means that the holder must observe the business custom as to opening and closing hours at the place of payment. It has been held in some adjudged cases that presentation may be made at the residence of the maker after business hours.

"BILLS RECEIVABLE" AND "BILLS PAYABLE"

Better Bookkeeping Practice in Designating Accounts—Separate Accounts for Bills and Notes—Separate Trade Acceptance Account

Bills and Notes Distinguished.—The term "bills receivable" is sometimes used synonymously with the term "notes receivable"; and the term "bills payable" with the term "notes payable." More specifically, the titles "bills receivable" and "bills payable" refer to bills of exchange, or drafts drawn by one party on a second in favor of a third party. When a bill of exchange is drawn to run for a stated period, that is, a time bill, it is presented to the drawee, or the party drawn on, as soon as possible for acceptance, in order to convert it into the drawee's direct obligation. When accepted, a bill is practically identical with a promissory note, and when the two forms of obligations handled are relatively few, either as receivables due to the business or as payables due from the business, it is customary to put the bills receivable in the same account as the notes receivable; and the bills payable with the notes payable account.

Designation of Accounts.—Formerly, it was customary to designate the account as "Bills Receivable" or "Bills Payable," as the case might be, but modern bookkeeping practice favors the use of the titles "Notes Receivable" or "Notes Payable," as being more definite and avoiding possible confusion with invoices, which are also referred to as bills. Where, however, the volume of transactions in which bills of exchange and promissory notes is heavy, it might be desirable to carry two accounts instead of one—one for bills of exchange and the other for notes. It is at times advisable, however, to segregate in a separate account from other bills and notes, the trade acceptances, because they are based on particular sales of goods under special banking rules applying to them and enjoy a superior rating when discounted by banks. The account is termed "Trade Acceptances Receivable" or "Trade Acceptances Payable."

SALES DISCOUNTS TO CUSTOMERS GIVING NOTES

Special Sales Discount Column in Note Register—Posting Entry Made in the Note Register

Recording Sales Discount in Note Register.—In some businesses it is the policy to allow a customer a sales discount when he gives a note, just as though he had paid cash. The amount of the note is, therefore, less than the amount of the sale with which his account has been charged. Accordingly, the credit to be passed to his account through the notes receivable journal will be a different amount from the face amount of the note received in payment of the account. When this condition is met with, the note register will have separate money columns for Notes Receivable, Sales Discount, and Accounts Receivable. In the Notes Receivable column is entered the face of the note; in the Sales Discount column, the amount of the discount; and in the Accounts Receivable column, the amount with which the customer's account is to be credited.

Posting the Entry.—The Sales Discount column in the notes receivable register corresponds to the Sales Discount column in the cash receipts journal in which the discount is entered when the payment is made in cash instead of by note. The credit postings to the individual customers' accounts are made as the notes are received. At the end of the month, when the notes receivable register is closed and posted, the summary entry consists of a debit to Notes Receivable in the general ledger for the total of the Notes Receivable column, a debit to Sales Discount for the total of the Sales Discount column, and a credit to Accounts Receivable in the general ledger for the total of the Accounts Receivable column.

NOTES RECEIVABLE DISCOUNTED

Recording Contingent Liability upon Indorsement of a Note—Difference in Entries Between Interest-Bearing and Non-Interest-Bearing Note

Discounting a Note.—When a business has received and holds a note, it may turn it into cash before its maturity by "discounting" it, that is to say, by selling the note to a bank or a person willing to buy it. The bank or other party taking the note deducts from its face amount, if it is non-interest-bearing, a sum equal to the interest it is charging on the note, which is known as the bank discount. This bank discount is an interest charge, and is recorded by debiting Interest Expense.

When a note is discounted, the firm selling it must indorse it and assume the liability of an indorser. Although this liability is merely a contingent one, inasmuch as it will not become an actual liability unless the note is not paid by its maker at maturity, it is nevertheless desirable to keep a record of all discounted notes outstanding in order to show the amount of the contingent liability. This is done by crediting all notes discounted to the account called Notes Receivable Discounted, instead of to Notes Receivable. When the notes mature and are paid, Notes Receivable Discounted is debited and Notes Receivable credited. This removes the contingent liability from books of indorser who discounted the note.

Bookkeeping Entries Illustrated—Non-Interest-Bearing Note.—The entries made upon the discount of a note receivable are illustrated in the following examples, in which a note for $4,600, running for 90 days from its date, is discounted at a bank at 6% interest per annum when it still has 63 days to run, the amount of the bank discount being accordingly $48.30 and the proceeds of the discount $4,551.70 (see page 247). When the note is discounted, the entry is:

Cash in Bank	$4,551.70	
Interest Expense	48.30	
Notes Receivable Discounted		$4,600.00
90-day note of T. D. Taylor & Co., dated June 6, and discounted July 3 at First National Bank, at 6% per annum.		

When the note matures and is paid by the maker, the firm which has discounted it is released from its contingent liability as indorser. It therefore makes the following entry:

Notes Receivable Discounted	$4,600.00	
Notes Receivable		$4,600.00
Payment of 90-day note of T. D. Taylor & Co., dated June 6, at the First National Bank.		

This entry is made soon after the note's maturity. It is not necessary to be informed of its payment before making the entry, because the indorser of the note is not liable on it in any case, unless he is informed promptly of its dishonor.

Interest-Bearing Note.—If the note to be discounted is interest-bearing, the entries may differ somewhat. If a 3 months' note of $4,000, bearing interest at 6%, is discounted on June 12 at 6%, the value of the note when due is $4,060. The proceeds of the discount is $4,020.08 and the interest earned is $20.08 (see page 248). The entry at the time of discount is:

Cash	$4,020.08	
Notes Receivable Discounted		$4,000.00
Interest Earned		20.08

The credit to the Interest Earned account is for the amount of the proceeds of discount in excess of the face amount of the note. If the amount of the proceeds were less than the face amount of the note, as it might be if the rate of discount were sufficiently in excess of the rate at which the note bears interest, the difference would be charged to Interest Expense account, as in the case of a non-interest-bearing note.

When the note is paid at maturity, the firm discounting the note is relieved of its contingent liability and makes the following entry:

Notes Receivable Discounted	$4,000.00	
Notes Receivable		$4,000.00

NOTES RECEIVABLE REGISTER OR JOURNAL

When Used as a Memorandum Book and as a Journal—Method of Posting—Notes Received from Others Than Customers

Data Required to be Recorded.—The promissory note is a negotiable or transferable instrument and when received by a business must be cared for as though it were so much cash. It is particularly important that the due date of a

Notes Receivable Journal

Date Rec.		No. Note	From Whom Received	L F	Amount	Date of Note	Time	Due Date Year	J	F	M	A	M	J	J	A	S	O	N	D
19–																				
Jan.	4	1	J. B. Gavin	15	1,000 –	Jan. 3	3 mo	19–				3								
	10	2	A K. Ackerman	4	525 –	Jan. 10	60 da.	19–			11									
	21	3	R. S. Stover & Co	125	730 –	Jan. 19	10 da.	19–	29											
	30	4	K. L. Barber	8	1,250 –	Jan. 29	6 mo.	19–							29					
					3,505 –															
	30	Notes Receivable		2	3,505 –															
			Accounts Receivable	4		3,505–														

(left page)

Notes Receivable Journal

Rate of Interest	Where Payable	Maker	Indorsers	Remarks
6%	First National Bank	J. B. Gavin	None	Invoice of December 24
6%	Our office	S. T. Tovey	A. K. Ackerman	On account
7%	Hyde Park National Bank	R. S. Stover & Co.	None	Invoice of January 19
6%	Columbia Trust Company	K. L. Barber	None	Balance of account

(right page)

Notes Receivable Journal

note received be watched, because unless a note is presented for payment on its due date, the indorsers may be released from their liability on the note. It is also necessary to keep a careful record of the date of the note, length of time it is to run, rate of interest, place where it is payable, and the names of the maker and of the indorsers.

Notes Receivable Register as a Memorandum Book.—Space is not available for all this explanatory matter in the general journal, and a special form of record is therefore required. For this purpose the notes receivable register or journal is provided. One form of such register is shown on the preceding page, which provides special columnar headings for the required data. This special book may be used merely as a memorandum record for carrying the detailed explanation of the journal entry; or it may be used as a special journal and be an integral part of the bookkeeping system. If it is employed as a mere memorandum book, it does not displace the general journal, from which the posting will be made by debiting Notes Receivable on the general ledger and crediting some other appropriate account, as a customer's account, if the note is received in settlement of the account. The general journal explanation will contain a reference to the notes receivable register, where a memorandum is made of all the details of the note.

Notes Receivable Register Used as a Formal Journal.—If, on the other hand, the notes receivable register is treated as a regular journal, all postings will be made directly from it and no entry will be made in the general journal. If the notes are from customers, they will be posted to the credit of the customers' accounts from day to day, and a reference will be made to the means of settlement in the explanation columns of these accounts. No debit entry will be made until the end of the month when the register is summarized and closed by totaling the amount column and posting the total to the debit of Notes Receivable in the general ledger. At the same time, a summary credit for the total will be passed to Accounts Receivable on the general ledger. The method of closing the notes receivable register and summarizing the entry is shown on page 243. The summary credit to Accounts Receivable will not duplicate the credits made to individual customers' accounts during the month, since when a trial balance is taken preliminary to closing the books, it will only include the balance of Accounts Receivable and not the balances of the individual customers' accounts.

When a note is paid, payment will be recorded in the cash receipts book, the postings from which will be a debit to Cash and a credit to Notes Receivable.

If notes are also received from others than customers, as for example, from employees who have borrowed money, two amount columns may be provided instead of one. In the one headed Accounts Receivable will be entered the notes received from customers, while in the other, headed "Sundry," will be entered the notes received from others. A column will also be added to adjoin the "Sundry" column in order to show the account to be credited when notes are received from persons other than customers. Complete postings as to these notes will be made from day to day. The summarizing entry on the notes receivable register will appear as follows:

				Accts. Receivable		Sundry	
		Notes Receivable	2	$5,260	–		
		Accounts Receivable	4			$4,250	–
		Sundry	√			1,010	–

The check-mark opposite "Sundry" in this entry indicates that no posting is to be made, as individual credit postings were made to the miscellaneous accounts during the month.

BANK DISCOUNT

Nature of Bank Discount—Manner of Computing It—Interest-Bearing and Non-Interest-Bearing Notes

Definition.—Bank discount is the amount deducted by the bank from the face of the note or draft for cashing it before its date of maturity. It is really the interest charged by a bank for a loan, secured by the note, equal to the matured value of the note. Business concerns, receiving such business paper from customers, frequently convert it into cash by thus disposing of it to a bank. The bank ordinarily will not accept the paper without the indorsement of the concern presenting it for discount, as it may not have any knowledge of the maker or drawer of the note or draft, nor can it rely on him solely for its payment. This accommodation of discount is usually extended by a bank to its clients carrying regular deposit balances with it and is subject to such other terms as may be agreed upon between the bank and the depositors.

Computation of Discount.—The discount is computed at a simple interest rate on the face amount of the note or draft, if it is non-interest-bearing, from the date of the discount to the date of maturity. The proceeds of the discounted paper is the amount received from the bank, or the face value of the note or draft less the discount. This amount the bank credits to the client's account, and is therefore subject to disbursement by check. Banks usually compute the term of the discount in exact days. In certain states by law, both the date of discount and the date of maturity are included in the term of discount. In practically all states, if the due date of a note or draft falls on a Sunday or a holiday, the note or draft is payable on the succeeding business day. In addition to the discount or interest charge, the bank deducts a fee to reimburse itself for the cost it will incur when it collects the note from the maker upon maturity. This is called collection and exchange charge.

In arriving at the amount of the discount, banks first compute one day's interest on the matured value of the note. The interest is computed on the basis of 360 days in the year. The one day's interest is multiplied by the exact number of days in the discount period. One day's interest on a given note is computed by the following general method.

Face amount of note	$3,200.00
One day's interest at 6% is equal to 6% of $3,200, divided by 360, or	.53

Non-Interest-Bearing Note.—Notes presented to a bank for discount are either non-interest-bearing or interest-bearing notes. The method the bank uses in computing the discount and proceeds of a note that bears no interest is shown in the following.

Example: To find the proceeds of a 4 months' note of $3,200, dated August 4, and discounted the following September 26, at 6%, with collection charges of 1/10%:

Date of maturity	December 4	
Terms of discount from September 26 to December 4 is	69 days	
Face value of note		$3,200.00
Discount for 69 days at 6% per annum	$36.57	
Collection charges 1/10% of $3,200	3.20	
Total charge		39.77
Proceeds		$3,160.23

Interest-Bearing Note.—The same method of calculating the discount and proceeds is used when a note bears interest. It must always be remembered that the discount is figured upon the matured value of the note. Therefore, if the note is interest-bearing, the matured value will include the face of the note plus interest for the full term of the note. The discount is then deducted from the sum of the face of note plus interest to maturity. This gives the net proceeds or the amount of cash the bank advances against the note.

Example: To find the proceeds of a 3 months' note of $4,000, bearing interest at 6%, dated May 10, and discounted June 12, at 6%:

Due date	August 10	
Term of discount—unexpired time June 12 to August 10	59 days	
Value when due	$4,000.00	
Plus 6% interest for 3 months	60.00	$4,060.00
Rate of discount	6%	
Discount:		
59 days—6% on $4,060, or		
60 days	$ 40.60	
Less 1 day	.68	39.92
Net proceeds		$4,020.08

PARTIAL PAYMENT AND RENEWAL OF NOTES

Entries on Books of Maker and Payee—Treatment of Uncollected Balance—When Old Note Merely Extended

Partial Payment.—If partial payments are made on a note, the entry on the payee's books on the occasion of each payment is a debit to Cash and a credit to Notes Receivable. On the books of the maker of the note, the entry is a debit to Notes Payable and a credit to Cash. If when the note is due, only a partial payment is made, the payee should make the entry in the usual way to record the partial payment. The uncollected balance should be debited to the maker's account, as in the case of a completely dishonored note, the offsetting credit being to Notes Receivable.

Renewals.—When a note is renewed, it is usually better to deliver up the old note and secure a new one in its stead. The accounts should reflect the transaction by showing a cancellation of the old, and the receipt of the new note. The journal explanation should show clearly the reason for the entry. Usually the note is renewed for the same amount. Accordingly, on the payee's books, the cancellation of the old note is effected by debiting the maker's account and crediting Notes Receivable, and the receipt of the renewed note is recorded by debiting Notes Receivable and crediting the maker's accounts. Instead of the two-fold entry, a single one may be made by simply crediting Notes Receivable to cancel the old note and debiting the same account to record the renewal note. On the books of the maker of the note, Notes Payable is debited to record the retirement of the old note and credited to record the issuance of the new note.

If the old note is merely extended and not replaced by a new note, no entry is necessary, but a memorandum of the fact should be made in the ledger account, Notes Receivable, on the payee's ledger, and Notes Payable on the maker's ledger.

NOTES PAYABLE REGISTER OR JOURNAL

Various Forms of the Register—When Used as a Formal Journal or as a Memorandum Record—Posting and Closing

Posting and Closing of Notes Payable Register.—Where promissory notes are made and issued rather frequently, a special register or journal should be used for making the entries in order that all the essential facts concerning the notes may be recorded, as in the case of notes received (see page 243). A form of such a register to record notes given to creditors is shown on the following page.

The register is posted and closed as follows. The individual amounts in the amount column are debited to the respective creditors' accounts from day to day. At the close of the month, the column is footed and ruled as shown in the form, and an entry is made debiting Accounts Payable on the general ledger and crediting Notes Payable on the general ledger with the total. The summary debit made to Accounts Payable will not duplicate the individual debits made

Notes Payable Journal

Date Issued	No. Note	To Whom Given	L F	Amount	Date of Note	Time	Due Date Year	J	F	M	A	M	J	J	A	S	O	N	D
19—																			
Aug. 4	41	Acme Letter File Co.	4	1,000 –	Aug. 3	3 mo.	19—											3	
10	42	Eversharp Pencil Co.	18	425 –	10	60 da.	19—										9		
21	43	Boston Specialty Co.	9	830 –	19	10 da.	19—								29				
30	44	Atlas Tablet Co.	7	1,150 –	29	2 mo.	19—										29		
				3,405 –															
		Accounts Payable	14	3,405 –															
		Notes Payable	15		3,405–														

(left page)

Notes Payable Journal

Rate of Interest	Where Payable	Maker	Indorsers	Remarks
6%	Hamilton National Bank	Company	None	On account
6%	Eversharp Pencil Co.	Company	None	Bill of August 2d
7%	Chelsea Trust Company	Company	None	Balance of account
6%	Atlas Tablet Company	Company	None	Bill of August 25th

(right page)

Form of Notes Payable Journal

in the course of the month to the creditors' accounts, because when the accounts are posted and a trial balance is taken, only the balance of Accounts Payable will be included and not the balance of the individual creditors' accounts.

The Register Merely as a Memorandum Record.—Sometimes the notes payable register is used as a memorandum record only. That is, no postings are made from the register. The register merely keeps the detailed information about each note. When the register is used as memorandum record, the entry for the giving of each note is made on the general journal in the same manner as when no note register is used.

More Complex Forms of Registers.—Where notes are issued for purposes other than payment to creditors, a note register of more complex form with additional columns for debiting other accounts will have to be used.

BASIS OF THE JOURNAL ENTRY

Necessity of Proper Authorization of Every Journal Entry—Journal Explanation When Authorization Made Verbally

Necessity for Proper Authorization of Entries.—Since the journal as the book of original entry, including the special journals used, is the channel through which the records of transactions involving adjusting, correcting, closing, and other similar entries, find their way into the ledger, it is very essential that nothing be entered in the journal unless properly authorized by some business paper or a memorandum approved or signed by one in a position to pass on such questions. A system of bookkeeping which observes this principle very rigidly is more likely to result in correct records than when this principle is not observed. Moreover, the bookkeeper making the journal entries is protected by such a system, since if any question should later arise as to why a particular entry was made, he can point for his authority to a particular business paper or memorandum approved or signed by some one over him. If authorization is made verbally, then the explanation in the journal should indicate this in the following manner—"as per J. Smith."

Business Papers and Memoranda Forming Basis of Entries.—The original business papers are used as the basis of the journal entry so far as possible. In the case of a purchase in a comparatively small business, the vendor's invoice provides the authority as well as the data for recording it in the general or the purchase journal. On the other hand, in a large manufacturing business where the bookkeeping system is more elaborate and subject to closer supervision, a special voucher may be prepared from the invoice. This will show precisely how the entry for the purchase is to be recorded on the books. In the case of sales, a duplicate of the invoice forwarded to the customer may serve as the basis of the entry. Entries in the cash journal will be based on the information shown on the stubs of the check-book or duplicate records of the checks drawn. In the case of receipts, the entries will be made from a copy of the cash sheet prepared by the one who actually handles the receipts. For notes received or issued the entries will be made from the notes themselves. For other entries the basis may be supporting schedules, summaries, and similar papers, prepared so as to serve the purpose of memoranda as well as the basis for a summary journal entry. The payroll is a familiar example of such summaries or supporting schedules. Special invoices for telephone service, insurance, and other similar expenditures may be used if the check-book stubs are insufficient for this purpose. In some instances, as where depreciation is recorded or a dividend declared, some memorandum from an executive officer may have to be used for the purpose of showing the authority for the entry.

MAKING THE JOURNAL ENTRY

Importance of the Journal Entry—Purposes Served by It—Procedure in Journalizing

Book of Original Entry.—All transactions must be journalized, that is to say, entered in the general or some special journal, from which the entry is then posted to the proper ledger accounts. The journal, general or special, is therefore a book or original entry, whereas the ledger is one of final entry. Inasmuch as the journal entries form the basis of the ledger record, it is very important that they should be properly and accurately made. The importance of the journal may be gathered from the fact that in a lawsuit only the journal, as the book of original entry, is admissible as evidence in proving some particulars concerning a transaction.

Characteristics of the Journal.—Whether the journal used be in the general form, or in a special form, as in the case of the sales journal or the purchase journal, it has three main characteristics:

1. It is in the nature of a diary, with the entries made chronologically according to dates of transactions.
2. It is an analytical and classifying record. Each transaction is analyzed so as to show which account or accounts are to be debited and the amounts, and which account or accounts are to be credited and the amounts.
3. It carries a brief but comprehensive summary or explanation of all the conditions and facts relating to the transactions, so that if referred to at some future time, this portion of the journal record will call to mind the essential facts concerning the entire transaction. However, instead of the explanation of the transaction appearing in the journal, there may be simply a reference by number or otherwise to the document which contains all the information, as the invoice or voucher in the case of purchases.

Chicago, Illinois, January 2, 19— (Page 1)

		Martin Kellogg began the			
		wholesale rug and carpet business			
		at 1279 State Street with a cash			
		investment of $50000.—			
		Cash	1	50000 —	
		Martin Kellogg, Capital	4		50000 —
		3			
		Mdse. Purchases	5	17000 —	
		Cash	1		17000 —
		Bot from Boston Rug Co. for			
		cash invoice of rugs $17000 —			

January 4, 19— (Page 2)

		Mdse. Purchases	5	12000 —	
		Philadelphia Carpet Co.	3		12000
		Bot of Phila. Carpet Co. n/30			
		invoice of carpet $12000 —			
		5			
		F. S. Scott	2	4000	
		Mdse. Sales	6		4000
		Sold to F. S. Scott n/30			
		invoice of rugs and carpets $4000.			

Pages from a Simple Journal

Form of Simple Journal.—A simple form of journal is shown in the above illustration, in which parts of two consecutive pages are reproduced. In this instance the date columns to the extreme left of the journal page are not used. The practice may be followed of beginning each day's entries with a new page, so that it is only necessary to place the date at the head of each page, or merely indicating the date in the center of the line preceding the entry. In the wide column are shown the accounts to be debited and credited for each transaction and this is followed on a separate line by the explanation of the transaction. The narrow column to the right of the broad column is for insertion of the ledger folio or page number of the account in which the respective debits or credits have been entered. The last two columns are for the purpose of entering the money amounts. The debits are entered in the first column and the credits in the second.

Procedure in Journalizing.—Making journal entries is called journalizing. The following are the steps, to be taken in order given, in journalizing a transaction:

1. Write the date at the top of the page, if the plan of beginning each day's entries with a fresh page is followed. Otherwise, insert the date in the date column, opposite the first entry of the day, or place the date in the center of the page on a separate line, in the manner shown in the illustration above.
2. Write on a separate line the title of the account to be charged in the wide middle column, beginning at the extreme left. Insert the amount of the debit in the left money column.
3. On the next line in the wide middle column, slightly indented, enter the title of the account to be credited, and place the amount of the credit in the right money column.
4. On the line below the credit entry, write a brief explanation which will set forth with sufficient clarity the essential facts about the transaction.
5. Leave a line blank after each entry. If the date is entered in the middle of the line just above the entry, it is good practice to show the date for each entry, even though the same date may be repeated a number of times.

POSTING THE JOURNAL

Posting Procedure Explained and Illustrated—When Journal and Ledger Are and Are Not Cross-Indexed—Use of the Folio Column

Posting Procedure.—The journal entry for a particular transaction shows the ledger accounts to be debited and credited. Posting is the process of making those debit and credit entries in the ledger. The steps taken in posting are given below.

To post the *debit element* of a journal entry:

1. Turn to the ledger page on which the account to be debited appears by consulting the index in the front part of the ledger.
2. Enter on the debit side of the account:
   - (a) The date of the journal entry in the first or date column.
   - (b) In the wide middle or explanation column enter whatever explanation of the transaction giving rise to the debit entry is required. Frequently, however, the explanation given in the journal will prove sufficient, and the explanation column in the ledger account may be left blank.
   - (c) In the narrow column to the right of the explanation column insert the journal page or folio from which the account is posted.
   - (d) Place the amount of the debit in the amount column.
3. After the ledger entry is completed, turn to the journal page and insert in the ledger folio column the number of the page in the ledger, of the account to which the journal entry has been posted.

Post the *credit element* of the journal entry in a similar manner.

Instead of the method outlined above, the procedure is sometimes followed of making all debit postings first and then all credit postings. This method may have advantages where there is a proneness to make a debit instead of a credit posting, or vice versa.

Cross-indexing of Journal and Ledger.—Entering the journal page in the ledger account and the ledger page in the journal entry has two purposes. First, as a cross-reference between the journal entry and the ledger account, so that the bookkeeper, when examining a particular entry in the ledger account, can refer at once to the journal entry which gave rise to it. Second, insertion of the ledger folio in the journal serves to indicate that the posting of the particular entry has been made, and the bookkeeper always knows to what extent the posting work has been completed. Where, however, the insertion of the ledger folio in the journal is not necessary, because the particular account to be debited or credited can be found without the aid of such cross-reference, a check-mark should be entered in the ledger folio column of the journal to indicate the completion of the posting of the particular entry, including that made to any subsidiary ledger. This check-mark system is used, for example, in posting customer accounts to loose-leaf cards arranged alphabetically.

Example: The posting procedure is illustrated by the following example of a journal entry of a credit sale of merchandise. Where several items appear in the explanation of this one journal entry, these are usually arranged in tabulated form, as shown.

New York City, July 1, 19–

F. S. Scott		48	$4,000.00	
Merchandise Sales		76		$4,000.00
Sold to F. S. Scott, n/30:				
10 Oriental Rugs at $108	$1,080.00			
20 Royal Wilton 9 x 12 at $97	1,940.00			
490 yd. Axminster Carpet at $2	980.00			
Total	$4,000.00			

The accounts, F. S. Scott and Merchandise Sales, when posted, appear as follows:

(*Debit, p. 48*)

F. S. Scott

19—					
July	1		12	4,000	–

(*Credit, p. 76*)

Merchandise Sales

19—					
July	1		12	4,000	–

Note that only the total amount of each transaction appears in the debit and credit columns of the journal and is posted to the ledger. The amounts of the individual items composing the transaction are only shown in the explanation of the journal.

FORMS OF THE GENERAL JOURNAL

When Special Columns Are Desirable in the General Journal—Posting Transactions Entered in the Special Columns

Special Columns in Journal.—In a small business where no special journals are used to record particular types of transactions, such as cash receipts or cash disbursements, or purchases or sales, the general journal is the book of original entry for all transactions, as well as for all adjusting, corrective, and closing entries. In a larger business permitting the use of special journals, the general journal is used only for such entries as are not made in the special journals.

The simplest form of general journal is that shown and explained on pages 254 and 255. If there are many transactions of the same kind, and no special journal is provided for them, it is advantageous to provide special columns for them in the general journal, which serve somewhat the same purpose as special journals. For example, if a business receives frequently notes from customers in settlement of their accounts, or issues many notes of its own, instead of opening

GENERAL JOURNAL

NOTES RECEIVABLE	GENERAL	DATE		ACCOUNTS AND EXPLANATION	F	GENERAL	NOTES PAYABLE
		19—					
374 –		Apr.	2	Notes Receivable	√		
				A. W. Ryan	72	374 –	
				Rec'd his 30-day note in full of account.			
	1,000 –		7	Blackman & Co.	37		
				Notes Payable	√		1,000 –
				Gave them our 60-day note for inv. #6. See Pur. J. p...			
	240 –		19	Smith & Jones	84		
				H. W. Smith	22	240 –	
				To correct error in charging H. W. Smith for sale #27 made to Smith and Jones.			
	600 –		24	Donovan & Sturgis	76		
				Notes Payable	√		600 –
				Gave them our 30-day note to apply on account.			
800 –			30	Notes Receivable	√		
				Burke & Hughes	32	800 –	
				Rec'd their 30-day note on a/c.			
700 –				Notes Receivable	√		
				C. A. Mullen	46	700 –	
				Rec'd his 30-day note on a/c.			
1,874 –	1,840 –					2,114 –	1,600 –
	1,840 –		30	General	√		
	1,874 –			Notes Receivable	8		
				General	√	2,114 –	
				Notes Payable	15	1,600 –	
	3,714 –					3,714 –	

(a) General Journal with Special Columns to Record Transactions of Frequent Occurrence

a note register, it may suffice to simply provide separate columns in the general journal to record the notes receivable or the notes payable. All other transactions will be entered in the general debit and general credit columns of the journal.

Divided or Split-Column Journal.—The arrangement of the columns of the general journal which is provided with special columns, usually takes the form shown in (a), which is called the "divided" or "split-column" journal. The distinguishing characteristics of such an arrangement is that the debit columns, both special and general, are on the extreme left of the page, and the credit columns, both general and special, are on the extreme right of the page, with the date, account classification and explanation, and ledger folio columns in between.

This arrangement may be varied slightly by omitting the date column and entering the dates in the center of the account classification and explanation column, and providing two folio columns, one for the debit and another for the credit entry of each transaction. This form of the journal is shown in (b).

General Journal

Notes Receivable		General		F	Date, Accounts, and Explanation	F	General		Notes Payable	
					April 2, 19—					
374	–			√	Notes Receivable					
					A. W. Ryan	72	374	–		
					Rec'd his 30-day note in full of a/c.					
					7					
		1,000	–	37	Blackman & Co.					
					Notes Payable	√			1,000	–
					Gave them our 60-day note for inv.					
					#6. See Pur. J. p...					

(b) General Journal with Special Columns, but Without the Date Column

Posting of Special-Column Journal.—Use of special columns in the general journal renders unnecessary the daily posting of the individual transactions recorded in these columns. One summary posting at the end of the month for the total of each column suffices. Thus, in form (a) shown on page 259, the only posting of notes received and notes issued is at the end of the month when the columns are footed and the totals are posted respectively to Notes Receivable and Notes Payable accounts. Individual postings, however, are made of the entries in the general columns. To prove the mathematical accuracy of such a journal, the summary entry is made in the manner shown in form (a). This summary includes the totals for the two general columns. The sum of the two debits must equal the sum of the two credits. As detailed postings have already been made of the entries in the two general columns, no postings should be made of their totals in the summary entry, and this is indicated by the insertion of check-marks in the folio column.

Special Debit and Credit Columns for Customers' and Creditors' Accounts.—In another form of the divided journal—see (c) on the following page—special columns are provided on both debit and credit sides of the page, for accounts payable and accounts receivable. The purpose of two accounts receivable columns, one debit and one credit, is to enter all transactions affecting individual customers' accounts other than the original charges for sales, which are made in the sales journal, and the later credits for cash receipts, which are made in the cash receipts book. The principal transactions so recorded are returned sales and allowances, notes and acceptances received on account, and correction of errors. This form of the general journal serves somewhat the same purpose as the special sales returns and allowances journal. Similarly, the purpose of the two accounts payable columns, one debit and one credit, is to record transactions other than the original credits for purchases which are made in the purchase journal or voucher register, and the later debits for cash payments made to creditors, which are made in the cash disbursements journal or check register. Such transactions chiefly arise out of returned purchases and allowances, notes, and acceptances given on account and the correction of errors

General Journal

Accounts Payable	Accounts Receivable	General	F	June 4, 19—	F	General	Accounts Receivable	Accounts Payable
600 –	60 –	1,100 –	√	Amounts Forwarded	√	635 –	1,050 –	75 –
				5				
		550 –	6	Notes Receivable				
				L. M. Brown	7		550 –	
				Received 30-da. note with int. for sale #2. See S. J.				
				8				
2,000 –			132	White Mfg. Co.				
				Notes Payable	11	2,000 –		
				Gave our 90-da. note for bal. of inv. #2. See P. J. and C. D. J. p....				
				9				
		200 –	46	Returned Sales				
				Wm. Smith	29		200 –	
				Sent Credit Memo. #5 to Wm. Smith for goods returned from sale #12 because they were not the kind he ordered.				
				17				
115 70			7	Brown & Drew				
				Returned Purchases	29	115 70		
				Returned to Brown & Drew from inv. #10, merchandise duplicated on the inv.				
				28				
	700 –		72	H. Smith & Bro.				
				H. W. Smith	56			700 –
				To charge H. Smith & Bro., a customer, for sale #13 which was incorrectly charged to H. W. Smith, a creditor.				
2,715 70	760 –	1,850 –				2,750 70	1,800 –	775 –
		1,850 –	√	General				
		760 –	8	Accounts Receivable				
		2,715 70	12	Accounts Payable				
				General	√	2,750 70		
				Accounts Receivable	8	1,800 –		
				Accounts Payable	12	775 –		
		5,325 70	√		√	5,325 70		

(c) General Journal with Special Columns for Entering Special Transactions Affecting Customers' and Creditors' Accounts

GENERAL JOURNAL

Month of ____________ 19–

(1)	(2)			(8)			(4)			(5)	(6)			(7)			(8)		(9)		(10)		(11)	
Vouchers Payable Control Dr.	Factory Expense Control Dr.						Selling & General Expense Control Dr.			Particulars	Miscellaneous Accounts Dr.			Miscellaneous Accounts Cr.			Customers Ledger Control Dr.		Customers Ledger Control Cr.		Notes Receivable Control Dr.		Notes Receivable Control Cr.	
	No.	√	Amount	No.	√	Amount	No.	√	Amount		No.	√	Amount	No.	√	Amount	√	Amount	√	Amount	√	Amount	√	Amount
$			$			$			$	May 1			$			$		$		$		$		$
										Notes Receivable											√	7,900 00		
										To–District #1									√	2,000 00				
										District #2									√	5,900 00				
										Received from Customers.														
										May 31														
										Direct Labor	241	√	8,548 72											
	501	√	1,085 43							Indirect Labor														
							601	√	652 50	Salesmen's Salaries														
										Accrued Payroll				169	√	5,286 65								
										Payroll accrued to May 31														
5,236 50										Vouchers Payable														
										Notes Payable				162	√	5,236 50								
										Voucher No. 63 of May 21 paid by 30-day 6% Note														
$5,236 50			$1,458 69			$			$2,574 50				$878,794 22			$878,063 91		$		$48,025 00		$48,025 00		$10,000 00
(163)			(250)						(260)				(—)			(—)				(114)		(111)		(111)

(d) General Journal with Many Special Columns involving the creditors' accounts. The function served by the general journal in this respect is substantially that of the special purchase returns and allowances journal.

Detailed postings are made of all amounts in the two Accounts Receivable columns to the customers' accounts in the customers ledger and of all amounts in the two Accounts Payable columns to the creditors' accounts in the creditors ledger. At the end of the month, all four columns are footed and the totals are posted in the one case to Accounts Receivable, and in the other case to Accounts Payable, on the general ledger. These postings to the two general ledger accounts are made from a summary journal entry made as shown in form (c). This journal entry includes also the totals of the two general columns, but merely for the purpose of proving the mathematical accuracy of the journal. These two totals are not posted, as shown by the check-mark against each in the ledger folio column.

The purpose of this form of general journal is to make summary monthly postings to the Accounts Receivable and Accounts Payable in the general ledger of the entries for certain more or less miscellaneous transactions affecting customers' and creditors' accounts. Such summary postings may be desired for other accounts as well, in which case the general journal will have additional columns as shown in form (d).

JOURNAL VOUCHER

The Loose-leaf General Journal—Journal Voucher Sheets Inserted in a Binder—Placed in a File

Purpose of the Journal Voucher.—The general journal, or the journal, or miscellaneous journal, as it is also called, receives all entries not provided for in special journals. In its old-fashioned form it is a bound book.

A growing practice in many establishments is to substitute for the bound book a journal consisting of loose leaves, which are placed in a binder or simply placed in a file. In such a loose-leaf journal, each sheet is reserved for a single entry, and, being numbered serially and approved by the proper official, it is known as the journal voucher. The postings to the ledger accounts are made directly from these sheets. A form of journal voucher is shown herein.

JOURNAL VOUCHER

Date	Description		Remarks

In favor____________Approved   Voucher No.________

Address____________   _____   ____________

Date

Audited by__________   _____   ____________

Paid_____19__ Check No._____   Amt. $____________

Form of Journal Voucher

Form of Journal Voucher.—The journal voucher provides space for the various particulars of the transactions recorded, as well as space for the officials approving and auditing it, and other matters, as shown by the form below. In addition it is supported by the miscellaneous business papers connected with the transaction and which, therefore, afford a complete explanation of it. If the journal voucher sheets are inserted in a binder, these papers may be filed separately after being given the number of the journal voucher. When desired, they can be found in the file by means of the journal voucher number. If the journal voucher is merely placed in a file, the supporting papers can be attached to it.

The voucher journal has several advantages over the old-fashioned form of journal. First, together with the related business papers it provides a complete record of the particulars of the transaction and no awkward explanations have to be made in the journal. Secondly, it provides a convenient and uniform method for the company official concerned giving his approval of the entry.

MISCELLANEOUS JOURNALS AND SUPPORTING SCHEDULES

Registers, Summaries, and "Recap" Sheets Used as Journals—Use of Payroll Book as a Memorandum Record or as a Journal

Besides the usual journals, general and special, a business may use sundry other kinds of journals involving forms and rulings to meet its particular requirements. These records may be called journals, or "registers," "summaries," "recap sheets," etc., but if the items recorded therein are posted directly to the ledger accounts, these records are in reality special journals, whatever their form or title. On the other hand, if the amounts entered on these records must first appear in some regular journal, from which they are posted to the ledger accounts, these records then are not journals themselves, but are either the basis of journal entries or are merely memorandum records which do not form an integral part of the accounting or bookkeeping system.

The ordinary payroll book, for example, is customarily a supporting schedule or memorandum record of the journal entry, as the amount of the payroll is usually passed through the general journal, or through the voucher register, from which the ledger is posted. On the other hand, in some concerns the postings are made directly from the payroll book, which is then a payroll journal, and is referred to as such.

STANDARD FORM OF LEDGER ACCOUNT

Various Columns Explained—When Explanation Column May Be Left Blank—When It Should Contain Information

Columnar Arrangement of Account.—The standard form of ledger account ruling is shown below. The title of the account, "Cash," appears at the top center. By the triple ruling, the account is divided into two parts: left or debit side, and right or credit side. Each side is ruled to provide columns, first for the date of the journal entry posted, the year-date being written at the head of the column; second, the broad column for any explanation or particulars regarding the entries or transactions recorded; third, a narrow column for inserting the initials of the journal and its page from

Cash

19	—					19	—				
Jan.	1	Balance		250	–	Jan.	31		24	230	85
	31		24	582	24	Feb.	28		28	340	50
Feb.	28		28	739	40	Mar.	31		30	210	14
Mar.	31		30	540	32			Balance		1,330	47
				2,111	96					2,111	96
Apr.	1	Balance		1,330	47						

Cash Account in Ledger

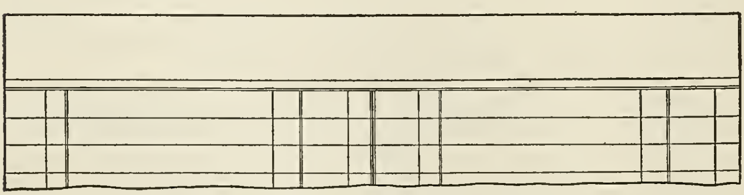
which the particular entry was posted; and fourth, the money amount column. The journal folio columns are separated from the amount columns by a double ruling.

Use of the Explanation Column.—The explanation column is frequently left blank because the particulars of the transactions can be found in the journal by looking up the page indicated in the folio column of the account. Sometimes it is desirable to carry in the ledger account certain information, briefly phrased, regarding certain types of transactions despite the fuller explanation in the journal. Thus, in the case of notes receivable, it is desirable to know the amounts of individual notes due and also the due dates, which may be given in the explanation column of the ledger account. It may be stated as a general rule that particulars should be given in the ledger explanation column, when reference to them is frequent. This avoids the necessity of continually turning to the journal entries. Sometimes when transactions are entered directly in ledger accounts, the offsetting debit or credit is shown in the explanation column. Some accountants insist upon the writing in the explanation column of each posting the offsetting debit or credit. The reason for this is that each posting becomes a complete journal entry. However, except in extreme cases, as where the journal records may be subpoenaed into court, this seems needless duplication.

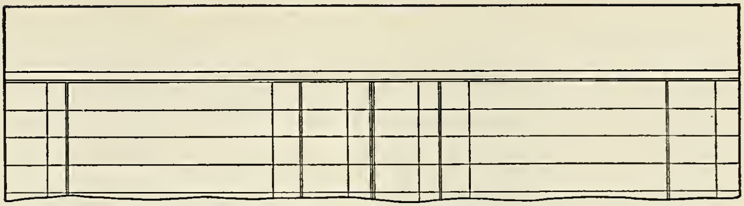
DIFFERENT TYPES OF LEDGERS—RULINGS

Use of Balance Columns in Connection with Personal Accounts—Progressive Form of Ledger

Standard Ruled Ledger.—Ledger rulings are either standard, balance, or progressive. The standard ruling—forms (a) and (b)—has two duplicate parts, a debit and a credit, usually divided in the center of the page with one money column appearing at the extreme right of each part, although



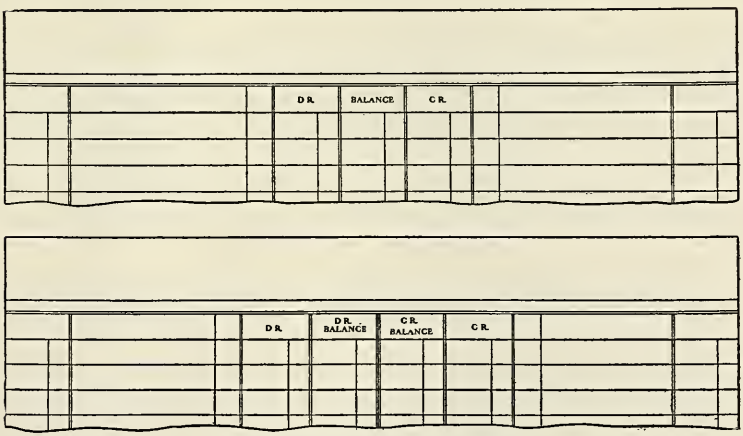
(a) Standard Ledger—Divided Column



(b) Standard Ledger—Center Column

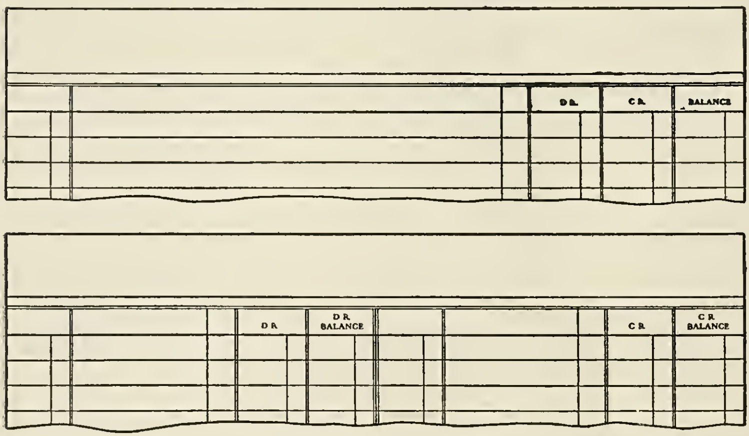
sometimes the arrangement is symmetrical with both debit and credit money columns at the center, and the date columns at either side of the page.

Balance Form of Ledger.—The balance ruling is a three- or four-column ledger with the money columns either at the center or at the right-hand margin, or at both the center and



(c) Balance Ledger Rulings

the right-hand margin. Typical forms of some of these are shown in (c) and (d). The extra columns are for the account balances. If the balance is usually either a debit or a credit, only one balance column is necessary. Where it is apt to be a debit at one time and a credit at another, separate debit and credit balance columns are advantageous. The balance ruling is used particularly with personal accounts, as those with customers or creditors, where there is need for an up-to-date balance. Where this kind of ledger is used, entry of new debits or credits should always be on the next blank line as shown in the balance column, so as to allow the extension of the new balance opposite the last entry even though this should leave blank several of the preceding lines on the debit and credit sides.



(d) Balance Ledger Rulings

Boston or Progressive Form of Ledger.—The Boston, progressive, or tabular ledger, as it is variously called—see form (e)—makes provision for a horizontal progress of the account as to sequence of time. The title of the account is written at the left-hand margin, and one or more lines are allowed to each account according to the degree of its activity. The account title is written once at the left margin of the master or main sheet, and is sometimes repeated at the right margin if the sheet is very wide. The page is divided into columns for each day or other divisions of the period. To effect this, short-margin insert sheets must usually be bound

DEPOSITORS		MONDAY			TUESDAY			WEDNESDAY			
Name	Balance	Checks	Deposits	Balance	Checks	Deposits	Balance	Checks	Deposits	Balance	
John Smith	500 —	200 —		300 —	150 —	1000 —	1150 —	etc.			

(e) Boston Ledger Sometimes Used for Depositors

in to give the desired room for accommodating a whole period's record. This style of ruling was formerly much used in banks where a daily balance for each depositor's account is necessary. It is capable of adaptation to other uses, however. The three column balance ledger account with all columns at the extreme right is an adaptation of the Boston bank ledger account. This account form is used most often in machine postings.

DIFFERENT TYPES OF LEDGERS—BINDINGS

Advantages of the Loose-Leaf and Card Ledgers—Division of the Ledger for Posting Purposes—Some Shortcomings

Three Kinds of Ledgers.—From the standpoint of the bindings, ledgers may be classified as solid-bound, loose-leaf, and card ledgers. The solid-bound ledgers are simply ordinary bound books, from which no pages can be removed and into which no pages can be inserted. The loose-leaf ledger consists of loose pages inserted in a binder, to which additional pages can always be added and from which any pages can always be removed. The card ledger simply consists of a list or file of loose cards or sheets.

Advantages of Loose-leaf and Card Ledgers.—The loose-leaf and card ledgers have obvious advantages over the bound ledger. They are, first, more flexible. They lend themselves easily to any desired grouping of the accounts; they may be arranged alphabetically; or they may be arranged numerically where accounts are numbered instead of named; or they may be arranged by classes and each class made self-indexing; or a geographical grouping may be made. Another advantage of loose-leaf and card ledgers is the ability to discard or file away in other binders or files all "dead" accounts, thus making the "live" ledger smaller and more easily handled. It is possible for several clerks to work simultaneously, since the leaves or cards may be distributed among any number of clerks. For example, if the number of active accounts is large, one bookkeeper may post all those numbered 1 to 250; another bookkeeper may post all accounts numbered 251 to 500; etc. Each bookkeeper would have a separate loose-leaf ledger file or binder. There is always the possibility, however, of failure to return a leaf or card, or of placing it out of regular order when returning it, or of destroying it, if it were desired fraudulently to do away with any particular account.

ARRANGEMENT OF ACCOUNTS IN THE LEDGER

Arrangement of Balance Sheet Accounts—Summary and Clearing Accounts—Income and Expense Accounts

Order of Balance Sheet Accounts.—The individual accounts in the ledger should be so arranged as to facilitate the preparation of the financial statements from the trial balance. It therefore follows that the order or sequence of the items appearing in the balance sheet and the profit and loss statement should be the governing factor. The groups of accounts appearing in the ledger will be first of all the current asset accounts—namely, Cash, Notes Receivable, Accounts Receivable, Reserve for Doubtful Accounts, Inventories, and Temporary Investments. Following this group appear the fixed assets such as Land, Buildings, Depreciation Reserve for Buildings, Machinery, Depreciation Reserve for Machinery, Tools, Patterns, Furniture and Fixtures, Reserve for Depreciation of Furniture and Fixtures, etc. Subsequent to these appear such accounts as the Intangible Assets, Deferred Charges, and Other Assets. The current liabilities, such as Notes Payable and Accounts Payable, come next followed by the fixed liability accounts, such as Bonds Payable or Mortgage Payable. The final division of the balance sheet is known as the proprietary accounts. If the business organization is a single proprietorship or partnership, then the individual capital and drawing accounts appear at this point in the ledger. If the business is a corporation, then there will appear the preferred stock accounts, the common stock accounts, and the surplus accounts.

Summary or Clearing Accounts.—In the ledger, following the balance sheet accounts, are the summary or clearing accounts, which are the accounts used to summarize or clear the results of the profit and loss statement into the balance sheet. These are the Profit and Loss account, the Cost of Goods Sold account, and the Manufacturing account. These accounts are set up in this section of the ledger at the very outset of the accounting year, even though no entries may be made in them until the close of year.

Income and Expense Accounts.—There are now only the profit and loss statement accounts still to be shown on the ledger. First come the income accounts which include Sales, financial management income accounts, such as Purchase Discount and Interest Earned, and Other Income. The expense accounts follow and include manufacturing costs, such as

Wages, Raw Material, Freight on Raw Materials, and Manufacturing Expenses; selling expenses, such as Salaries, Traveling Expenses, Commissions, Advertising, Administrative Expenses; general expenses and financial management expenses.

WRITING AMOUNTS IN JOURNALS AND LEDGERS

Care Required in Writing Figures—Omission of Dollar Mark—Use of Zeros or Dash in Cents Column

Since the money columns in the journals and ledgers represent dollars and cents, it is not necessary nor is it accepted practice to write the dollar sign with any amounts appearing in these columns. The columnar indication is sufficient. The unnecessary use of the dollar mark also gives use to the danger of mistaking it for a figure. For this reason many banks request depositors not to use the dollar mark on deposit slips. The bookkeeper should, however, be careful to write the figures accurately, carefully, and directly under each other, if in the same column. Errors are frequently made by making 7 appear like 1, or 0 like 9, or 3 like 2, etc. Likewise, a large number of errors arise from figures in the same column not appearing directly under each other, so that in totaling columns the wrong figures are added.

As a further precaution in writing figures, in journals and ledger, if the amount being entered is an even amount of dollars, without any cents, the bookkeeper should write either two zeros in the cents column or a dash, to indicate that there are no cents. There are several reasons for this practice. First, it later assures the bookkeeper and the accountant that the amount is completely entered and that no cents have been inadvertently omitted. Second, it prevents subsequent fraudulent alteration of the amount. Whether to use two zeros or a dash, there is little preference, since they both accomplish the same result. But one must be used.

TRANSFERRING AND CLOSING LEDGER ACCOUNTS

Methods of Transferring Account to Another Page—Common Methods of Ruling When Accounts Are Closed

Transferring an Account to Another Page.—A separate ledger page is usually allotted to each account. When that page is filled and it is necessary to transfer the account to another page, this may be accomplished in either one of two ways.

First, the account on the old page may be balanced, and only the balance transferred to new page. When balanced the account appears as shown in (a) below. Note that first the amount columns of the account are footed and the totals inserted in small pencil figures which may later be erased. The difference between the totals is the balance, and the calculation may be made in the vacant explanation column in pencil and then erased. The balance is then added to the side of the account with the smaller amount so that both sides of the account now total to the same amount. A reference is also given to show the page to which the account is transferred. The totals of the two sides thus balanced are written directly opposite each other on the same line, and double rulings are drawn underneath across all columns except the explanation column. On the new page the balance carried forward is entered as shown in the illustration (b).

A second and preferable method of transferring an account is to carry over the two columnar totals as shown in (c). The columns are added and the totals are first inserted in small figures, and then as formal totals of the columns, with double rulings underneath. On the new page each column has its respective total, with a reference made in the explanation columns to the number of the page from which the transfer is made.

CASH (Page 1)

19—					19—					
Mar.	1		1,500	00	Mar.	3			205	00
	7		10	00		6			550	00
	10	1,635	125	00		8			10	00
		765	1,635				Balance		765	
		870					Carried for. to p. 20		870	00
			1,635	00					1,635	00

(a) Cash Account

CASH (Page 20)

19—										
Mar.	10	Balance from p. 11		870	00					

(b) Cash Account in which Balance Is Brought Forward

CASH (Page 1)

19—					19—					
Mar.	1		1,500	00	Mar.	3			205	00
	7		10	00		6			550	00
	10		125	00		8			10	00
		Carried forward to p. 20	1,635	00			Carried forward to p. 20		765	00

CASH (Page 20)

19—					19—					
Mar.	10	Brought forward from p. 1	1,635	00	Mar.	8	Brought forward from p. 1		765	00

(c) Cash Account in Which Totals Are Brought Forward

Closing an Account.—When a customer ceases to do business with the concern, his account is closed. It is balanced in the same manner as when it is transferred to a new page. In the case of a customer's account it may be closed only when he has made full payment, and hence will not show any balance, the totals of the two amount columns being equal. These amounts will be placed on the same line in their respective columns, and double rulings will be drawn underneath across all columns except the explanation column. A customer's account may also be closed when it is written off as a bad debt, or when the customer returns the goods he has purchased and does no further business with the concern.

Accounts with customers may be closed at the end of every month so as to show the balances due and payable. The balance is brought down on the first line of the debit side underneath the double ruling. Similar procedure may be followed with creditors' accounts, but the balances will be brought down on the credit side of the account.

If an account is closed by transferring its balance to another account, an entry of the transfer will be made in the general journal, the account being closed will be debited or credited with the amount of its balance, and the account to which the transfer is made will be treated in the opposite manner in the journal entry. All reserve and expense accounts are closed in this manner when the books are closed at the end of the accounting period, and their balances are transferred to the Profit and Loss account.

Ledger Account Rulings Illustrated.—All the profit and loss accounts must be ruled at each closing of the books. All the balance sheet accounts may be ruled at each closing. Customarily, however, only those balance sheet accounts having numerous entries are ruled to indicate clearly the point at which an account has been balanced and proved. If ruled, the balance must be brought down.

PETTY CASH

19–						19–					
Jan.	21	To start fund	CD1	50	00						

(1)

CASH IN BANK

19–						19–					
Jan.	3		J1	10,000	00	Jan.	3		J1	50	00
	4		J1	450	00		3		J1	500	00
	31		CR1	4,590	39		3		J1	1,875	00
							9		J1	2,500	00
							11		J1	1,000	00
							15		J2	750	00
							15		J2	95	00
							15		J2	45	00
							31		CD1	1,641	25
							31	Balance	√	6,584	14
				15,040	39					15,040	39
Feb.	1	Balance	√	6,584	14						

(2)

A. BROWN—CAPITAL

19–						19–					
Jan.	31	January drawings	J7	300	00	Jan.	3	Investment	J1	10,000	00
	31	Balance	√	9,947	30		31	January profit	J7	247	30
				10,247	30					10,247	30
						Feb.	1	Balance	√	9,947	30

(3)

FREIGHT-IN

19–						19–					
Jan.	19		CD1	64	50	Jan.	31	To Profit & Loss	J7	64	50

(4)

SALES

19–					19–				
Jan.	31	To Profit & Loss	J7	4,118 75	Jan.	4		J1	450 00
						6		J1	400 00
								S1	3,268 75
				4,118 75					4,118 75

(5)

Common Methods of Ruling Ledger Accounts

Common methods of ruling ledger accounts are illustrated in forms (1) to (5).

(a) Balance sheet account containing only one posting is not ruled. See form (1).

(b) Balance sheet account containing several postings is ruled as in forms (2) and (3) and balance is brought down in the manner shown. Footings of debit and credit columns must be opposite each other.

(c) Balance sheet account in balance with only one debit and one credit is shown as in form (4).

(d) Profit and loss account containing only one debit and one credit is closed and ruled as shown in form (4).

(e) Profit and loss account containing several debits and/or credits is closed and ruled as shown in form (5).

(f) Note that the single rule line extends across the money columns only; the double rule lines cover date, folio, and money columns.

(g) Rulings must be neat. Use a ruler in making them.

(h) Note that the balance figures in real accounts ruled off do not come from a book of original entry; hence, the folio column shows a check (√) mark to indicate that no posting is involved.

THE GENERAL LEDGER AND SUBSIDIARY LEDGERS

Controlling Accounts in the General Ledger—Relation of Subsidiary Ledgers to Controlling Accounts—Form of the General Ledger

Relation of Subsidiary Ledgers to General Ledger.—Every business must have a general ledger, which is *the* ledger. It is complete in itself and contains in individual or summary accounts the complete business record. From it the trial balance is taken, and through the trial balance the balance sheet and profit and loss statement are prepared. However, some of the accounts in this general ledger are summary accounts. Instead of showing separately and in detail a number of related accounts, these accounts may be combined and summarized into one general account on the general ledger for purposes of convenience. The detailed accounts are then carried in separate books, called subsidiary ledgers. Illustrations of these related accounts are the customers' accounts or the creditors' accounts.

While subsidiary ledgers are frequently spoken of as subdivisions of the general ledger, it must be remembered that the general ledger remains complete in itself, though as to certain groups of related accounts, it may contain only general or summarizing accounts, which are known as "controlling" accounts. The general ledger, being *the* ledger, is an integral part of the double-entry bookkeeping system. The rule that for every debit there must be a credit of equal amount, applies to it only and not to the subsidiary ledgers. On the other hand, the subsidiary ledgers may be viewed merely as expansions of certain accounts in the general ledger. The subsidiary ledgers are not really a part of the double-entry system. They do not balance and they are not complete in themselves. They are better viewed as purely memorandum records supporting the related general, summary, or controlling accounts in the general ledger. Hence, when a summarized debit, representing the total of a debit column in a journal, and made to a controlling account in the general ledger, is apparently duplicated by the detailed debits for the same total amount made to the individual accounts in the subsidiary ledger, the principle that for every debit there must be an equal credit is not violated because that principle strictly applies only to the general and not to the subsidiary ledger.

System of Controlling Accounts as a Check on the Accuracy of Posting.—Every subsidiary ledger supports, or is controlled by, a general or controlling account on the general ledger. The two must naturally be in agreement—that is, the aggregate of the balances of the detailed accounts in the subsidiary ledger must equal the balance of the controlling account on the general ledger. If there is a discrepancy, a mistake has been made somewhere in the postings. In addition to the convenience of keeping the detailed accounts in a separate book, or separate books, permitting several bookkeepers to work on the accounts when they are very numerous, the system of controlling accounts and subsidiary ledgers serves as a check on the accuracy of the posting because the summary entries made in the controlling account are made independently of the detailed entries made in the subsidiary ledger. The controlling account is therefore a check on the subsidiary ledger, and vice versa, the subsidiary ledger is a check on the controlling account.

Operation of Controlling Accounts and Subsidiary Ledgers Illustrated.—The system of controlling accounts and subsidiary ledgers is based on special journals or the columnarized general journal. The group of similar transactions, as for example, sales to customers, are entered in the sales journal. The work of posting the sales journal will be as follows: The individual customers' accounts in the subsidiary or customers ledger will be debited daily for the individual sales. But these debits are mere memorandum entries. There are really no offsetting credits. At the end of the month when the sales journal is balanced, the real double-entry record is made. This consists of debiting Accounts Receivable, the controlling account on the general ledger, and crediting Sales account for the total of the sales journal. Payments received from customers will be entered in a special column of the cash receipts book. When posting, the payments will be credited individually to customers' accounts in the subsidiary ledger, but again, these credits are mere memorandum records, since there are no offsetting debits. The real double entry is made at the end of the month, when the column in the cash receipts journal, showing payments received from customers, is totaled and an entry is made for the total amount of the column, debiting Cash and crediting Accounts Receivable in the general ledger.

If the posting has been correct, the balance of Accounts Receivable on the ledger must equal the sum of the balances of the customers' accounts in the subsidiary ledger. Moreover, it will be noticed that the debits and credits are made in monthly totals to Accounts Receivable on the general ledger and in detail to the accounts in the customers ledger. It will therefore be evident that the controlling account checks the accuracy of the customers ledger.

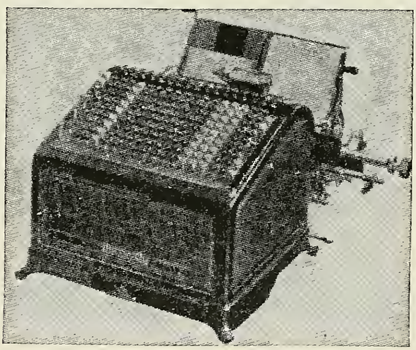
For further illustration of the operation of the system of controlling accounts and subsidiary ledgers, see "Customers Ledger" and "Creditors Ledger," and other types of subsidiary ledgers discussed in this volume.

Form of the General Ledger.—Although the general ledger is the most important book in double-entry bookkeeping, it has been relieved of much work by the prevalent use of columnar journals, subsidiary ledgers and control accounts. Bookkeeping machine methods are not applied to the general ledger to any extent, postings to which are still made generally by pen. Also, no changes in the rulings of the accounts in the general ledger have been made. These still retain to a great extent the form of the standard ledger account, although in many instances general ledgers are used with a special column to show the balance of each account.

POSTING SUBSIDIARY LEDGERS BY MACHINES

Procedure in Posting by Machine—Automatic Daily Proof of Postings—Simultaneous Preparation of Customers' Statements

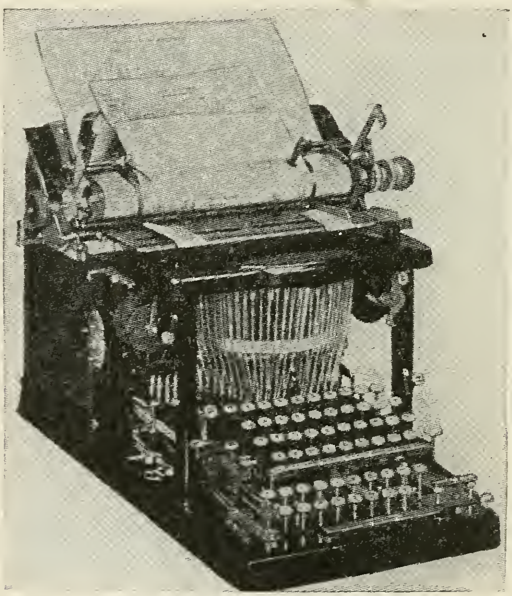
Routine in Posting.—The bulk of the posting work in a large bookkeeping department is in the subsidiary ledgers, such as the customers ledger or the creditors ledger. Where transactions are numerous, the volume of posting work is very heavy, and a number of clerks may be employed on a



High Keyboard Posting Machine

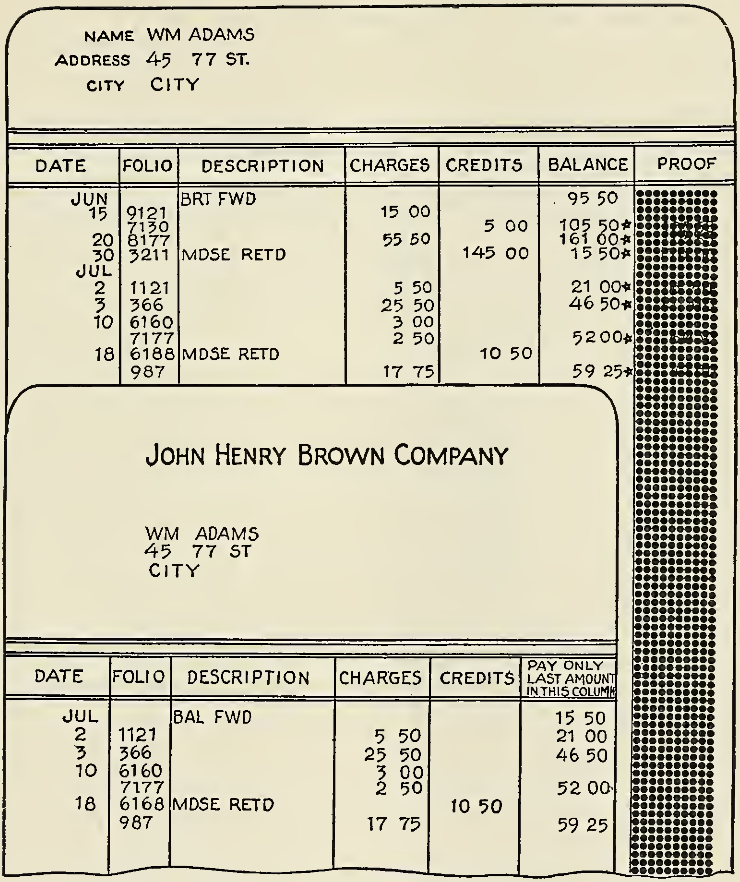
single subsidiary ledger. In order to lighten the burden, machines have been invented and are in quite general use to do the posting work. While there are many varieties of these machines, they combine the principle of the typewriter with that of the adding machine. Illustrations of two types of such machines appear herein.

To post a subsidiary ledger by machine methods, it should be in loose-leaf form, as bound volumes are not readily adapted to the application of posting machines. Especially ruled sheets, such as those shown on page 285, are used for the ledger when it is machine-posted. In preparation for the



Typewriter Posting Machine

posting work, the binder of the ledger is unlocked so as to permit the free withdrawal of the account sheets to be posted, and is placed in a convenient rack alongside of the posting machine. The account sheet to be posted is taken from the loosened binder and inserted in the machine. The first operation is to press down the keys for the figures of the old balance of the account in order that it may be accumulated and included in the new balance. The item or items to be posted are then typed on the sheet by manipulating the keyboard of the machine, and a total is thereupon taken off to represent



NAME WM ADAMS
ADDRESS 45 77 ST.
CITY CITY

DATE	FOLIO	DESCRIPTION	CHARGES	CREDITS	BALANCE	PROOF
JUN		BRT FWD			95 50	
15	9121		15 00			
	7130			5 00	105 50*	
20	8177		55 50		161 00*	
30	3211	MDSE RETD		145 00	15 50*	
JUL						
2	1121		5 50		21 00*	
3	366		25 50		46 50*	
10	6160		3 00			
	7177		2 50		52 00*	
18	6188	MDSE RETD		10 50		
	987		17 75		59 25*	

JOHN HENRY BROWN COMPANY

WM ADAMS
45 77 ST
CITY

DATE	FOLIO	DESCRIPTION	CHARGES	CREDITS	PAY ONLY LAST AMOUNT IN THIS COLUMN
JUL		BAL FWD			15 50
2	1121		5 50		21 00
3	366		25 50		46 50
10	6160		3 00		
	7177		2 50		52 00
18	6168	MDSE RETD		10 50	
	987		17 75		59 25

Specially Ruled Ledger Sheets for Use with a Posting Machine

the new balance. As the machine is equipped to subtract figures as well as to add, both debit and credit postings may be made and a running balance of the account taken off. When the posting is completed, it appears on the sheet as shown below, which contains an insert of a tally tape. The sheet is then withdrawn from the machine and placed to one side and another sheet is taken from the binder for the same operation. When the entire work is completed, the posted

SHEET NO 4

NAME A Customer RATING A-1

ADDRESS Anywhere TERMS 30 Days

BALANCE	REMARKS	DATE	MEMO	FOLIO	CHARGES	√	CREDITS
90.00		MAR 2		2345	45.00		
135.00 BAL		MAR 10	CS	81			90.00–
45.00 BAL		MAR 12		2912	10.00		
		MAR 12		2913	5.60		
60.60 BAL		MAR 15		3012	23.00		
83.60 BAL							

Proof

.00*
.00*
15.40
15.40*
3.75
6.22
108.09
118.06*
55.00
55.00*
32.50
27.50
60.00*
23.00
23.00*
271.46*

Ledger Sheet Illustrating Posting by Machine, with Tally Tape Insert sheets are restored to their places in the binder. The operation of the machine is a technical process, and the operator must receive instruction from one who is familiar with the characteristics of the machine, especially since the various bookkeeping machines have peculiar mechanical adaptations.

Sometimes the ledger records are kept on cards instead of loose-leaf sheets. In such instances a portable steel tray with alphabetical guide cards is used for a permanent record. Each tray has a capacity of approximately 3,000 cards. At night these trays are placed in a fireproof safe or vault for protection.

Daily Proof of Postings.—Some posting machines are equipped with an adding register which accumulates the total postings, and at the close of the day this total is compared with the amount posted to the controlling account, Accounts Receivable, from the special journals, such as the sales journal. The accuracy of the general ledger posting is thereby verified. On machines not equipped with such adding devices, a "tally-roll" is found (see insert in form on page 286) which furnishes a list of all debit and credit items posted. When the daily posting work is completed, the debits and credits are each added separately and the totals compared with the amount posted to the general ledger from the summary entry in the special journal.

Customers' Monthly Statements.—Another advantage of the posting machines is that monthly statements of customers' accounts may be made in the same operation in which an account is posted. Two sheets, with a carbon sheet between, are inserted in the machine and kept in the ledger binder. At the close of the month, the top sheet is mailed to the customer as a statement of his account. The accounts are kept on a monthly basis, and at the close of each month new accounts are opened by bringing forward the balances from the old sheets. A form of this statement is shown below.

STATEMENT

A Progressive Company

ANYWHERE

April 1

A Customer

Anywhere

Please return this stub with your check Amount enclosed $____________

Date	Reference	Charges	Credits	Balance
			Balance forward	90.00
MAR 2	2345	45.00		135.00 BAL
MAR 10 CS	81		90.00	45.00 BAL
MAR 12	2912	10.00		
MAR 12	2913	5.60		60.60 BAL
MAR 15	3012	23.00		83.60 BAL

Customer's Statement Prepared on a Posting Machine

PRIVATE LEDGER

Accounts Included in Private Ledger—Operation of Balancing Accounts—Profit and Loss Account on the Private Ledger

Function of Private Ledger.—The private ledger is a section of the general ledger containing a few accounts which proprietors or executives of the business desire to keep confidential. Most of the accounts will remain in the general ledger, and the bookkeepers will be constantly using them in their work. The few remaining accounts which the management does not wish to entrust to the ordinary bookkeeper, will be opened in a separate volume, the private ledger, to which none but certain officers or employees will have access.

Accounts Included in Private Ledger.—The accounts included in such private ledger should be limited to those which are significant and which would disclose certain vital facts about the business which the management prefers neither public nor employees should know. These accounts usually do not require frequent posting. In such a selection of accounts, the following, for example, might be included:

Profit and Loss	Investments
Trading	Mortgage Payable
Capital Investment	Executive Salaries
Merchandise Inventory	Land and Holdings

The proprietors or management of some businesses are reluctant to disclose the annual net earnings. They may fear that disclosure of the earnings, if their rate is high, might encourage competition in the same field. Therefore, some of the accounts without which the profits cannot be determined are set up in the private ledger. Examples of these accounts are Merchandise Inventory (if inventory taking is necessary to determine profits), the Trading account, and the Profit and Loss account. It may also be desirable to keep secret the capital investments, the withdrawals, or the share holdings of stockholders, or any mortgage indebtedness or the salaries paid to managing officials. Entries in the private ledger are first recorded in a private journal.

Operation of the Private Ledger.—Where the general ledger is thus split by the segregation of certain accounts in a private ledger, some method must be devised to enable the bookkeepers to complete their postings and prepare a trial balance even if they do not have access to the accounts in the private ledger. This is accomplished by opening two so-called balancing accounts—one on the general ledger entitled "Private Ledger" account, and the other on the private ledger entitled "General Ledger" account. The operation of these two interlocking or balancing accounts, sometimes called controlling accounts, may be illustrated thus: Suppose the Officers' Salaries account is on the private ledger. When checks for the monthly salaries are drawn, the bookkeeper will be directed to make an entry crediting Cash and debiting Private Ledger account. On the other hand, the proprietor, officer, or confidential employee in charge of the private ledger will make an entry on the private journal, debiting Officers' Salaries and crediting the General Ledger account. These two balancing accounts, one in each ledger, serve as a screen to hide from the view of unauthorized persons the accounts in the private ledger. Cash was credited on the general ledger, and Officers' Salaries was debited on the private ledger, but intervening between these two postings is a debit to one of the balancing accounts and a credit to the other.

Since for every debit posting made in the one balancing account, a credit posting of equal amount will be made in the other balancing account, it necessarily follows that there will be a debit balance in the one balancing account and a credit balance of exactly the same amount in the other. At the close of the accounting period, the two ledgers are combined. The balances on the two controlling accounts offset each other and cancel out; hence, the name, balancing accounts. If a private cash account is kept on the private ledger, a private cash book may be necessary in addition to a private journal.

Profit and Loss Account on the Private Ledger.—The Profit and Loss account is generally set up in the private ledger when the books are closed. Hence, all accounts of income and expense that are kept on the general ledger will have to be closed out on the general ledger and taken up on the private ledger. On the general ledger this will be done by:

Sales	$60,000.00	
Purchases		$45,000.00
Expense		11,000.00
Private Ledger		4,000.00
To close expense and income account.		

On the private ledger the entry will be:

Purchases	$45,000.00	
Expense	11,000.00	
General Ledger	4,000.00	
Sales		$60,000.00
To take up the expense and income accounts in the general ledger.		

Instead, however, of opening Purchases, and Sales and Expense accounts on the private ledger, these items may be posted directly to the Profit and Loss account on the private ledger which will appear as follows:

Profit and Loss

19–						19–					
Dec.	31	Purchases		45,000	—	Dec.	31	Sales		60,000	—
	31	Expense		11,000	—						

For the purpose of closing the accounts, the private ledger is now complete in itself, and the ordinary procedure of closing will be followed. In other words, the expense and income accounts, including the old and new inventory, found on the private ledger, will be closed out into Profit and Loss.

Closing the Books.—On the work sheet prepared preliminary to closing the books, there will be a trial balance taken from the general ledger and another taken from the private ledger. The balance of the Private Ledger account on the general ledger will offset the opposite balance of the General Ledger account on the private ledger. The elimination of these two balances will be shown in the adjustments column of the working sheet. With the exception of the two trial balances, made necessary by the existence of the two interlocking ledgers, the working sheet is not different from that prepared solely from the general ledger, when no private ledger is used.

BRANCH OFFICE ACCOUNTING

Head Office Current Account and Branch Office Current Accounts—Operation of Branch Accounting System Illustrated—Closing of Books

Head Office and Branch Current Accounts.—The principles of branch accounting are the same as those on which the private ledger is operated (see page 288), though its purpose is quite different. As in the case of the private ledger, the general ledger is in effect split up into parts which in branch accounting may be more than two, depending upon the number of branch offices conducted. Each ledger division contains the accounts kept by a branch located in a different part of the state or country. These divisions are called branch ledgers, and are interlocked with the general ledger containing the home office accounts, by a system of balancing or current accounts. On each branch office ledger there is set up a "Head Office Current Account," and on the head office ledger there is set up an account with each branch, as "Branch A—Current Account," "Branch B—Current Account," etc.

Accounts Carried in Branch Office Ledger.—The manner in which the general ledger for the entire business may thus be split up between the several branch offices and the head office will depend upon the way in which the operations of the business are organized. If operations are entirely or mainly centralized in the head office, the branch office will have few accounts to keep. For example, if the branch merely is a sales agency, forwarding all customers' orders to the main office, from which goods are shipped and the accounts collected, there will be no necessity for any formal accounting at the branch office, aside from some purely memorandum records of sales orders. On the other hand, if certain operations are entrusted to the branch, such as keeping a stock of merchandise, making shipments therefrom to customers, collecting the accounts, depositing the proceeds in a local bank, and paying its own expenses therefrom, the branch will have to keep a ledger on which it will set up accounts for Merchandise Inventory, Customers, Cash, Expense, etc. The head office will regularly ship merchandise to the branch office to replenish its stock, and periodically the branch office will remit cash to the head office, leaving only a working balance in its own bank account. These dealings between the branch office and the head office will involve entries in the two balancing or current accounts which the branch and the head office keep with each other—the Head Office Current Account on the ledger of the branch office, and the Branch Office Current Account on the ledger of the head office.

Operation of Branch Office Accounting Illustrated.—Suppose a branch office, which is organized and conducted in the manner explained in the preceding paragraph is allocated a certain amount of cash, which is deposited in a local bank. A quantity of goods valued either at cost or at an amount above cost to the head office, are shipped to the branch office and placed in a local warehouse.

In the branch office books, the journal entry will be:

Cash	$ 1,000.00	
Merchandise	10,000.00	
Head Office Current Account		$11,000.00

The journal entry on the head office books will be:

Branch Office Current Account	$11,000.00	
Cash		$ 1.000.00
Merchandise		10.000.00

The net effect of these two journal entries is simply to make a transfer from one Cash account to another, and to make a transfer from one Merchandise account to another. As the merchandise is sold and the accounts are collected by the branch office, the usual entries are made on the branch ledger to record the sale of merchandise, the collection of accounts and receipt of cash. When the merchandise stock is replenished from the home office, the journal entry will again be a debit to Merchandise and a credit to Head Office Current Account on the branch office books, and a debit to Branch Office Current Account and a credit to Merchandise on the books of the head office. As cash accumulates in the branch office bank account, periodical remittances are made to the main office.

The journal entry on the branch office books will be:

Head Office Current Account	$2,000.00	
Cash		$2,000.00

The journal entry on the books of the head office will be:

Cash	$2,000.00	
Branch Office Current Account		$2,000.00

In general, it may be said, that for every asset the branch office receives from the head office it credits the Head Office Current Account, debiting Cash, Merchandise, etc., as the case may be; and for everything it sends to the head office, it debits the Head Office Current Account, crediting Cash, or some other asset. Likewise, for everything the head office sends to the branch, it debits the Branch Office Current Account, crediting Merchandise, Cash, etc. For all values received from the branch, the head office credits the Branch Office Current Account, debiting Cash, etc.

Closing of Books.—The two balancing or current accounts, one on the books of the head office and the other on the books of the branch office, must have equal though opposite balances, except for any items in transit between the two offices, which have not yet been taken up on the books of the office to which they are being sent. The two current accounts will require reconciliation to that extent. When the books of the entire business establishment are closed, the branch office need only send a trial balance of its ledger to the main office, which will be combined with the trial balance of the main office ledger on the working sheet. The opposite balances of the two current accounts will cancel each other, as shown in the adjustment column of the working sheet, and otherwise the working sheet will be prepared as though the trial balance were taken from a single ledger.

More Complicated Situations.—The foregoing example is a comparatively simple illustration of the bookkeeping procedure in branch accounting. The relationships established between the head office and branch office may make this much more complicated. For example, the branch office may be conducted as though it were an independent business and expected to show a certain profit on the total capital that has been assigned to it by the head office. In such an instance, the branch office will close its books, and draw off a balance sheet and a profit and loss statement, which it will send to the main office in lieu of a trial balance. The current account on the books of the branch office will, under such conditions, have a credit balance, which will be the amount of the branch office's net worth.

COST OF MANUFACTURED GOODS

The Three Elements Comprising Manufacturing Cost—Elements of Cost, Expense, and Profit in Selling Price

Trading and Manufacturing Business Contrasted.—In a trading business, merchandise is purchased from wholesalers or manufacturers, and the same, identical items are resold in smaller quantities for the purpose of making a profit. The trader's function is to carry a stock of goods in the same condition in which they were bought so as to satisfy promptly his customers' needs. The cost of goods sold is merely the invoice price of the goods, plus such additional items of expense as freight and cartage paid in bringing the purchased goods to the store or warehouse.

In a manufacturing business, material is purchased and converted into a different commodity through the application of labor and manufacturing processes, and the products thus made are sold. The expenditures are, therefore, not merely for the commodities or materials purchased, as in the case of the trading firm, but also for the labor and certain general factory expenses required to fashion the purchased materials into the product or products intended for sale.

Elements of Manufacturing Cost.—The first of the three elements in the cost of manufactured goods, that for materials, is known as a direct manufacturing or factory cost of a particular lot of goods, or quantity of product, because the materials for which expenditure of funds has been made enter directly into the manufacture of those goods. The second element of manufacturing cost, or the cost of labor, that is applied in the production of goods, is also a direct manufacturing cost, because the cost is incurred directly in the production of a particular quantity of goods or other products. The third element in manufacturing cost is known variously as "factory expense," "factory overhead," "factory burden," and by other designations, and consists of certain charges necessary for operating the factory as a whole, and not therefore applicable to a particular lot of goods manufactured. Such general factory expenses include factory supplies, rent, taxes, insurance, depreciation of factory buildings, machinery, and other equipment, superintendent's salary, repairs and maintenance of the factory, heat, light, and power used in the factory, and the like.

Nevertheless, these general factory expenses incurred during a given period constitute a portion of the cost of the product manufactured during that period, and hence must be allocated to, or distributed over, the product on some fair basis in order to arrive at the total cost of manufacturing a particular quantity of goods. These costs or expenses are referred to as indirect manufacturing costs since they cannot be associated directly with the manufacture of a specific quantity of goods, but must be apportioned on some equitable basis. These expenses are incurred for the benefit of all the jobs manufactured in a given period, and not for one specific order of that product. The methods by which the general factory expense or overhead is distributed over specific lots or quantities manufactured in the same factory constitute one of the major problems of cost accounting.

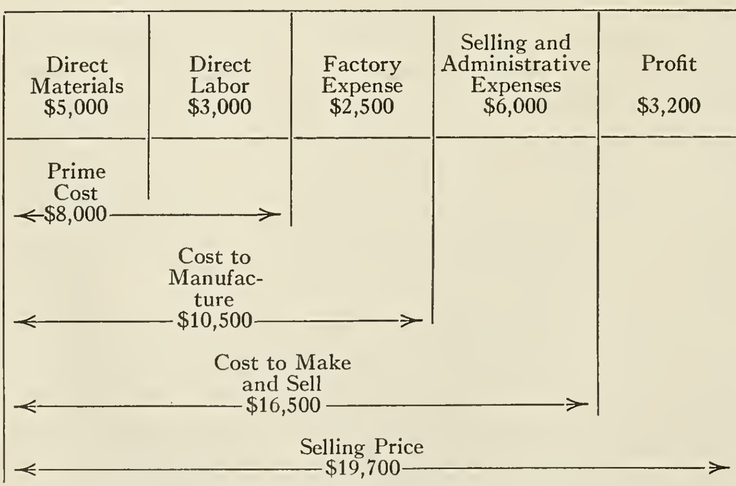
"Prime Cost" and "Cost of Manufacture."—Cost of materials entering directly into the manufacture of a specific quantity of goods, and labor applied directly in that manufacture, together comprise what is known as the "prime cost" of those goods. When a certain proportion of the general factory expense or overhead is added to this, the result is "factory cost" or "cost of manufacture," or "cost of manufactured goods," which corresponds to the purchase cost of the merchandise of a trading concern. That cost deducted from the price received for the goods when sold gives the gross profit on the sale.

Total Cost of Goods and Selling Price.—Selling and administrative expenses, comprising the remaining important groups of expenses in operating a business as a whole, whether trading or manufacturing, are not a part of the manufacturing or factory cost, any more than they are a part of the cost of merchandise in a trading concern. It is particularly important not to confuse them with the general manufacturing expenses or factory overhead, which is a part of the cost of manufacture.

Summary of Cost Elements.—From the foregoing explanation of the elements of cost and expenses in a manufacturing business, the following summary may be made, which shows the relation of the different elements:

1. Direct material and direct labor = Prime cost of manufacture.
2. Prime cost + Factory expense or overhead = Total factory cost or cost of manufacture.
3. Factory cost + Administrative and selling expense = Cost to manufacture and sell.
4. Cost to make and sell + Profit (or—loss) = Net selling price.
5. Net selling price − Cost of manufacture = Gross profit.

The foregoing elements of cost, expense, and profit included in the selling price are shown graphically below:



Elements in the Selling Price of Manufactured Goods

RECORDING MATERIALS USED IN MANUFACTURING

Controlling Account on General Ledger—Form and Operation of Subsidiary Ledger for Materials—Requisition Journal

Materials Account on General Ledger.—On the general ledger, in a summary or control account entitled "Materials," the purchases are recorded as debits. This account is sometimes called "Stores" or "Raw Materials," and shows in total the details given in the perpetual or book inventory—the materials ledger.

Whenever materials are purchased, an entry is made in the voucher register. Since there will be many such purchases, a separate column, representing debits to the Materials account, is used for all such entries. The total of this column is posted to the debit of the Materials account in the general ledger whenever the voucher register is summarized and ruled off. The offsetting credit is included in the total of the Vouchers Payable column of the voucher register, which is posted to the credit of the Vouchers Payable (sometimes called Accounts Payable) in the general ledger.

Materials Ledger.—A general or summary record of materials purchased or used is alone not sufficient for the purpose of ascertaining the cost of the materials entering into the manufacture of particular lots of goods. It is, therefore, necessary to keep also a subsidiary materials or stores ledger containing individual accounts for each type and class of materials used in manufacture. This ledger usually consists of a card file kept by the clerk in charge of materials or stores, and is frequently referred to as a permanent, book, or running inventory. Each card contains an account for a particular kind of material or supplies. The rulings of such cards vary somewhat. A typical one is shown on the following page. When a certain kind of material is purchased, the

Stores Ledger

ACTUAL RECEIPT PRICE	.15	.20			
AVERAGE PRICE	.15	.1708			

NAME *Bushings 3" Mall* PART NO. *56-678*
MINIMUM *100* MAXIMUM *300* LOCATION *L 3*
DRAWING NO. UNIT

	REFERENCE			QUANTITY		ON HAND		
	DATE	NUMBER	REMARKS	RECEIVED	ISSUED	QUANTITY	VALUE	
1	OCT 4	4523		100		100	15 00	1
2	OCT 10	34567			5	95	14 25	2
3	OCT 12	35654			10	85	12 75	3
4	OCT 13	38765			3	82	12 30	4
5	OCT 15	39458			12	70	10 50	5
6	OCT 16	4587		50		120	20 50	6
7	OCT 19	40156			10	110	18 79	7
8								8
9								9
10								10
11								11
12								12
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25								25
26								26
27								27
28								28
29								29
30								30

Stores or Materials Ledger Card

stores clerk enters the quantity and sometimes the price on the card used for that material. The entry is made from a copy of the receiving report which has been checked with the invoice. The total of the debit entries made in these cards, constituting the materials ledger, must therefore equal the total of the monthly charges made to the Materials account in the general ledger. The only difference between the charges on the materials ledger and the charges in the Materials account in the general ledger is that the charges are made in detail on the materials ledger, whereas the total of each invoice is entered in the Materials column of the voucher register, and the total of this column is posted at the end of the month to the general ledger Materials account.

Withdrawal of Materials from Stores for Manufacture.—The purpose of the materials ledger and the general ledger Materials account is to show the amount of materials on hand at any time in the storeroom. Materials are withdrawn from stores for manufacture by sending stores requisition orders to the storeroom. The respective accounts in the materials ledger must then be credited with the quantity so withdrawn. These entries are made from the requisition orders. The Materials controlling account in the general ledger must likewise be credited, but this is not done directly from the requisition orders. Instead, the requisitions are entered in a special journal, called a requisition journal, a form of which is illustrated herein. Entries are made in two columns, or are listed on a sheet called a stores requisition summary. If the materials enter into the article being manufactured, they are listed as direct materials; otherwise, as indirect.

At the end of the month the two columns are footed and the sum of their totals is posted to the credit of the general ledger Materials account, the offsetting debit being to Goods in Process (see page 315).

Requisition Journal

Date		Req. No.	Prod. Order	Description	Direct		Indirect	
19—				Brought Forward	5,756	00	180	00
Jan.	29	12	2	Paint for Finishing	4	00		
					5,760	00	180	00
				Dr. Materials in Process	5,760	00		
				Dr. Factory Expense	180	00		
				Cr. Materials			5,940	00
					5,940	00	5,940	00

Requisition Journal

Agreement Between Materials Control Account and Materials Ledger.—After posting at the end of the month, the Materials control account in the general ledger must "tie up" with the total of the materials ledger. That is, the balance of the Materials control account should equal the sum of the balances of all the individual cards in the materials ledger.

The entries on the Materials account in the general ledger may be indicated as follows:

Materials Ledger Control

19— Oct.	31	(From Voucher Register for Purchases)	VR8	9,760	–	19— Oct.	31	(From General Journal for Purchases returned to Vendor)	GJ6	275	–
							31	(From Requisition Journal for total of Requisitions of Materials used in manufacturing)	RJ7	5,940	–

The balance of $3,545 represents the amount of materials on hand in the storeroom and should agree with the total of the Materials account on the general ledger and with the physical inventory made of materials in store.

ACCOUNTING FOR LABOR COST IN THE FACTORY

Direct and Indirect Factory Labor—Use of Time and Job Cards —Preparation of Payroll—Entries for Labor Cost

Direct and Indirect Labor.—For purposes of accounting there are two kinds of factory labor. That commonly termed direct labor is the labor spent directly on the article being manufactured. For example, the labor of the worker who operates a machine which stitches the uppers of shoes manufactured by the factory, is direct labor. Indirect factory labor is labor which is not spent directly in making the factory product, but in the general supervision and maintenance of the plant and its operations. It includes the time and pay of the factory superintendent and his staff, of repairmen, of those attending to the heating of the factory and supplying it with power, of helpers, janitors, messengers, etc. Their labor enters into the cost of manufacturing the factory product as well as the labor of workers who spend their time directly in the manufacture of the factory product.

In-and-Out Time Card.—In most factories the employees are required to "check in" when they arrive at work in the morning or return after luncheon. They are also required to "check out" when going to lunch and when leaving work for the day. In small factories this checking is done by a clerk or the worker himself entering the time of his coming and going in a time book. In larger factories every worker is given each week a card, called the in-and-out card, which is kept in a rack near the entrance to the factory. The form of in-and-out time card is illustrated on the following page.

EARNINGS RECORD

NAME Norman Glass

CLOCK No. 3581 RATE .85

Date	D.W Hours	Remarks	EARNINGS Day Work	Piece Work	Standard	Total Earnings To Date
JAN 7			40 80			40 80
JAN 14			39 95			80 75
JAN 21			42 50			123 25

Received Payment of Wages for Week Ending

3581 Jan. 21

NORMAN GLASS

Signature ______________________

Address ______________________

Employee's Claim $ __________

3581 Jan. 21

NORMAN GLASS

RATE	HOURS	EARNINGS
.85	D.W. 50.	42.50
	P.W.	
TOTAL		

Day	IN	OUT	IN	OUT	IN	OUT
MON	6 54	11 33	12 15	5 06		
TUE	6 53	11 31	12 25	5 09		
WED	6 56	11 32	12 11	5 08		
THU	6 52	11 31	12 21	5 10		
FRI	6 55	11 30	12 18	5 02		
SAT	6 49	12 02				
SUN						

Trans. ________ To ________ From ________

Start ____________ Quit ____________

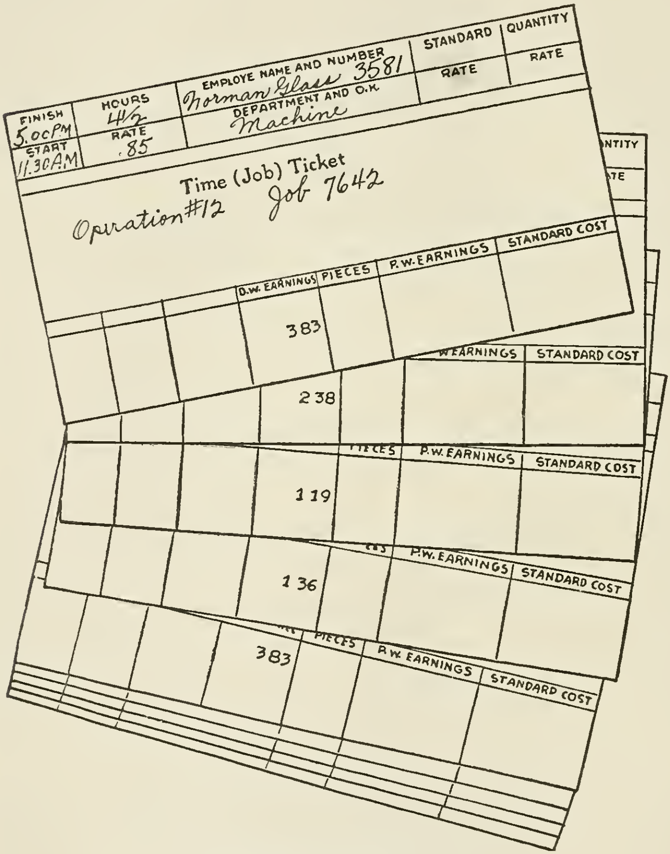
WORKING HOURS: Mon., Fri.—7 to 11:30 12:30 to 5:00. Sat.—7:00 to 12:00.

In-and-Out Time Card

This time card is especially designed for use with a time clock. Whenever the worker enters or leaves the factory, he inserts the card in the clock, and prints the time in the proper space by operating a lever. If he is late in arriving or leaves early, the time is usually printed in red ink on the card. If he is paid by the day or by the hour, the in-and-out card serves as the basis of the payroll, the worker being paid for the time he has spent in the factory. The card may not be necessary, however, if he is paid by the piece rate.

Individual Job Time Tickets.—In order to ascertain the cost of manufacturing each job or quantity of product, the accounting system of the factory includes a method for determining the amount of labor spent by all workers on each particular job. Each day every worker is given a number of job time tickets, specimens of which are shown below. One ticket is reserved for each particular job he has worked on during the day. At the end of the day when he turns in his tickets properly filled out, each ticket will bear his name and the number of the job he has worked on, and will show the department in which he is working, the kind of work he has done, his starting and finishing time, the total time thus spent, his hourly rate of pay, and the total cost of his labor that day on the particular job. His payroll is not prepared from these job time tickets, but from the in-and-out cards, as already shown.

It may happen that the total time shown on the worker's job time tickets is less than the time shown on his in-and-out cards. This will be because he has not spent all his time on particular production orders or jobs. He may have lost time in waiting for work to come to him; or he may have had to do some repairing on his machine. Any difference between the total time shown by his in-and-out cards and the total shown by his job cards is indirect labor, to be included in the general factory overhead expense, which will subsequently be distributed on some fair basis over all the production orders manufactured during the accounting period in which these expenses were incurred.



Individual Job Time Tickets

All the job time tickets turned in by the workers each day are sorted by their job numbers, and the pay amounts of the tickets bearing the same job number are added together on an adding machine tape. This represents the total direct labor cost incurred on that particular day in the manufacturing of the particular job. This total is therefore entered in the labor column against the date in question in the cost sheet for the particular job, on which are assembled all the costs incurred in manufacturing the job. (See page 314.)

Paying the Factory Worker.—At the end of each week the office force makes up the payroll from the in-and-out time cards. Columns may be provided in the payroll to show not only the total amount earned by each worker but also the portion of that amount constituting direct labor, or the cost of labor spent directly on a production order or job, and the portion constituting indirect labor, or the cost of labor not spent directly on any particular production order or job. The direct labor of each worker is obtained from the job time tickets, and the difference between this amount and his total weekly earnings is the indirect labor. A check is cashed for the total of the weekly payroll and the money is placed in the pay envelopes.

Entries for Labor Cost.—Two accounts are set up to record the labor cost in a factory—Direct Labor and Indirect Labor. The entries for the weekly payroll are given below.

When the payroll is prepared, the following entry is made on the voucher register:

Debit: Direct Labor
Indirect Labor
Credit: Vouchers Payable

When the payroll check is cashed, the following entry is made on the check register:

Debit: Vouchers Payable
Credit: Cash

At the close of the month, when the voucher register is balanced and posted, the Direct Labor account is closed out to Work in Process by the following journal entry:

Debit: Work in Process
Credit: Direct Labor
To close out Direct Labor into Work in Process.

At the same time, the Indirect Labor account is closed to Manufacturing Expense (or Factory Expense) account which contains all the overhead expenses which are to be distributed over the various jobs in course of manufacture, and entered in the respective cost sheets. The closing entry is:

Debit: Manufacturing Expense
Credit: Indirect Labor
To close out Indirect Labor into Manufacturing Expense.

When the amount in the Manufacturing Expense account is distributed to the various cost sheets, the account is closed out to Work in Process by the following journal entry:

Debit: Work in Process
Credit: Manufacturing Expense
To close out Manufacturing Expense into Work in Process.

BOOKKEEPING FOR FACTORY EXPENSE OR OVERHEAD

Controlling Account for Factory Expense on General Ledger—Subsidiary Ledger for Factory Expense—Various Types of Overhead Expenses

Items of Expenditure Comprising Factory Overhead.— Factory expense or factory overhead consists of those elements of cost of manufacture which are incurred for the benefit of production as a whole, and which are not chargeable directly to any specific product or job order, that is to say, a lot of goods in course of manufacture, but only indirectly by some method of allocation. These overhead expenses may be grouped into four classes, based on their bookkeeping treatment:

1. Indirect materials requisitioned from stores. These are the materials which do not enter into the manufacture of the finished article.
2. Wages of those men who do not work directly on the article being manufactured.
3. Services, such as light and power, for which cash outlays are made and which cannot conveniently be charged directly to each job but must be apportioned over the several jobs manufactured in the same period.
4. Other charges, such as those for depreciation, which are entered in the general journal.

Factory Expense Account on General Ledger.—On the general ledger there is one account, entitled Factory or Manufacturing Expense, to which monthly summary debits for all factory expenses are posted for the four different groups, given in the above classification. The procedure by which the debits finally reach the Factory Expense control account are shown by the diagram on the following page. On this diagram the material requisitions destined for general use in the factory and not entering directly into the manufacture of a specific lot of goods, are first entered in the "Indirect" column of the requisition journal, the entry being made from the requisition orders. At the end of the month, when the summary of requisitions is prepared, the total of the "Indirect Materials" column is debited to the Factory Expense control account. Labor expended in operating the factory generally and not directly on a specific quantity of product, that is to say, indirect labor, is first recorded from the individual time tickets of employees on the indirect payroll. The indirect labor of the payroll is entered in the Factory Expense column of the voucher register, the total of which is posted at the end of the month to the Factory Expense accounts. Cash outlays for such general services as light and power are first vouchered and then also posted to the Factory Expense control account in the general ledger.

FLOW OF ACTUAL FACTORY EXPENSE

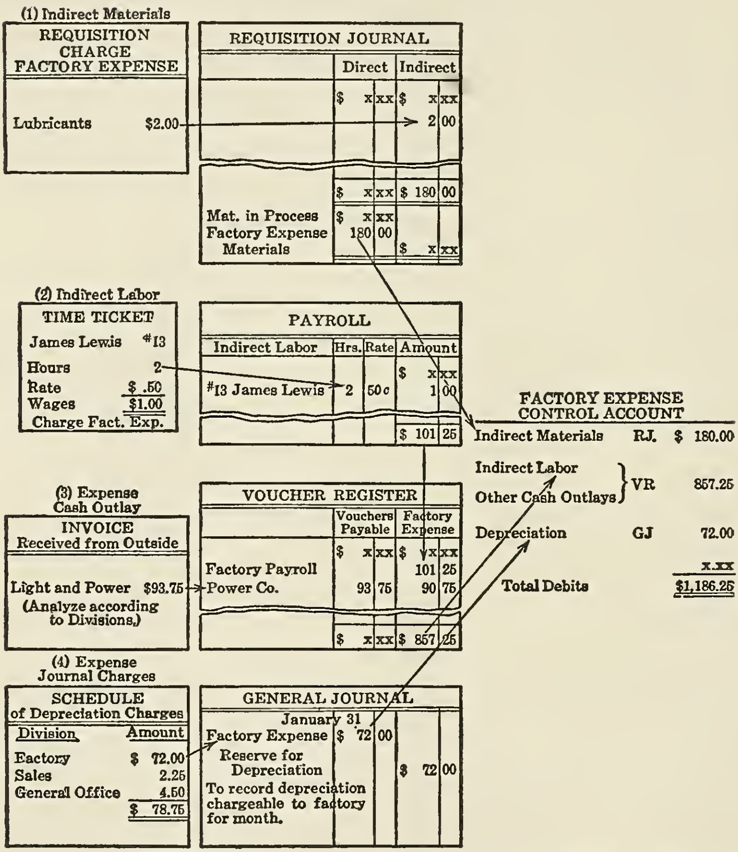


Diagram Illustrating Entries and Postings for the Several Types of Factory Expense

Finally, expenses representing accrued liabilities or adjustments such as depreciation are entered at the close of the month in the general journal, and from there posted to the Factory Expense account. The form below illustrates the Factory Expense control account in the general ledger after the monthly postings have been made. "RJ" refers to the requisition journal, "VR" to the voucher register, and "GJ" to the general journal.

FACTORY EXPENSE CONTROL

19—											
Jan	31	Indirect Labor	VR	408	20						
	31	Factory Supplies	VR	8	13						
	31	Repairs	VR	77	07						
	31	Miscellaneous	VR	18	10						
	31	Indirect Materials	RJ	180	00						
	31	Rent	VR	255	00						
	31	Light and Power	VR	90	75						
	31	Depreciation	GJ	72	00						
	31	Insurance	GJ	77	00						
				1,186	25						

Factory Expense Control Account on the General Ledger

Factory Expense Ledger.—In addition to the Factory Expense control account on the general ledger, there is a subsidiary ledger, called factory expense ledger, which is controlled by this account, and which contains the detailed factory expense accounts—those for water, light, power, depreciation, etc. Postings to these accounts are made for the individual items of expense from day to day during the month, from the requisition orders, time tickets, schedules, and other source forms.

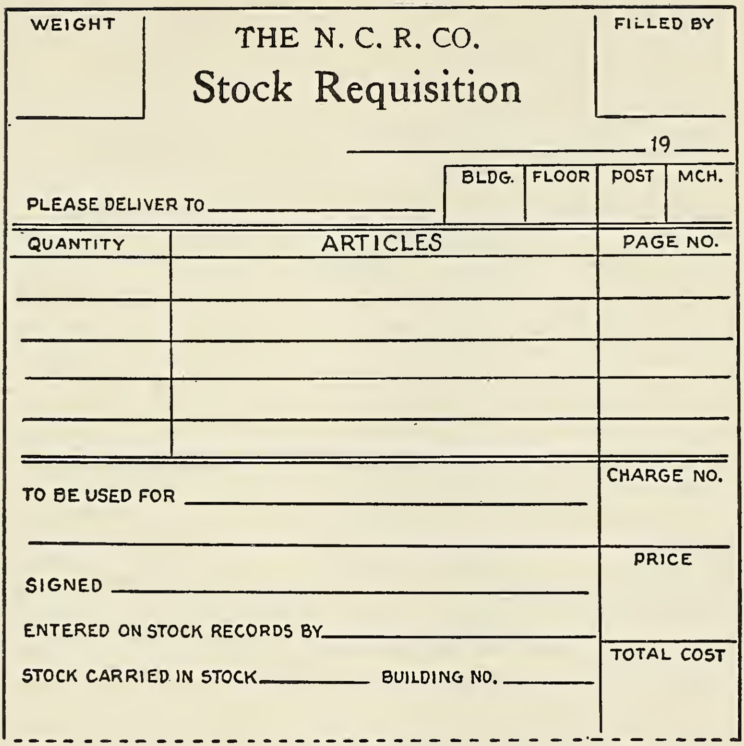
Agreement Between Factory Expense Account on General Ledger and Factory Expense Ledger.—It is evident that the sum of the charges made to the detailed accounts in the factory expense ledger must equal the balance of the general Factory Expense account on the general ledger at the close of the month, if the posting work was done correctly. The same postings have been made to the subsidiary ledger as to the control account, except that in the one case they were made by individual items of expense, while in the other by monthly totals in most cases.

RECORDS IN COMPILING COST OF MANUFACTURE

Records for Assembling Manufacturing Costs of a Particular Job or Order—Allocating Factory Overhead to Such Job or Order

The Three Elements of Manufacturing Cost.—The three elements which comprise the cost of manufacturing a particular quantity of goods are: the cost of materials, the cost of labor entering directly into the manufacture of those goods, and the general manufacturing expenses or factory overhead, a portion of which must be allocated to that particular quantity of goods in order to arrive at its total cost of manufacture. At the outset, therefore, it is necessary to set up accounts for each kind of material kept in the storeroom and used in manufacturing. In other words, unlike the case of the trading concern, a so-called perpetual, running, or book inventory must be kept of the different types of materials, as otherwise it would be impossible to arrive at the cost incurred in manufacturing a specific quantity of product. Accounts must also be kept for labor that are directly applied in manufacturing goods. Finally, a third group of accounts must be kept in the books for the various types of general manufacturing expense or factory overhead.

Method of Assembling Manufacturing Costs of a Particular Job or Order.—When the factory or production department receives directions to manufacture a specified quan-



WEIGHT	THE N. C. R. CO. Stock Requisition	FILLED BY

______________ 19____

PLEASE DELIVER TO ______________

BLDG.	FLOOR	POST	MCH.

QUANTITY	ARTICLES	PAGE NO.

TO BE USED FOR ______________ — CHARGE NO.

SIGNED ______________ — PRICE

ENTERED ON STOCK RECORDS BY ______________

STOCK CARRIED IN STOCK ________ BUILDING NO. ________ — TOTAL COST

Stock Requisition

tity of a particular kind of product, it first secures the necessary materials from the stores clerk in charge of materials. This is done by the use of requisition forms, a sample of which is shown herewith. The cost of the materials so withdrawn for the particular job is credited to, or entered in the "Issue" column of, the respective materials accounts. The total of the requisition orders is also entered on a special form called cost sheet, job sheet, or final cost record, which is used to accumulate the total costs incurred in manufacturing the particular lot of goods. This cost sheet is given a number for purposes of identification, such as "Production

PRODUCTION ORDER NO. 2
Cost of 20 Pcs. Article "X"
Made For Jones & Company
Date Begun January 25, 19–
Date Promised February 3, 19–

Direct Materials				Direct Labor		Machine Hours					
Date	Req. No.	Quantity	Cost	Date	Cost	1	2	3			Total
Brought Forward			$1,280 49		$312 00	112	216	192			520
1–29	12		4 00	1–31	3 60			6			6
			$1,284 49		$315 60	112	216	198			526

Summary	Amount	Estimated
Direct Materials	$1,284 49	$
Direct Labor	315 60	
Factory Expense	231 32	
Factory Cost (20 pieces)	$1,831 41	
Unit Cost	$ 91 57	

Factory Expense			
Machine	Hours	Rate	Amount
1	112	.537	$ 60 14
2	216	.446	96 34
3	198	.378	74 84
Total Factory Expense			$231 32

Form of Cost Sheet

Order No. 3," which is the number of the job in course of manufacture the costs of which are being accumulated. The form of this cost-assembling sheet is illustrated above.

When the materials requisitioned for the particular job order are put through the various manufacturing processes, the cost of the labor expended on the particular job is also entered on the cost-assembling sheet for the particular job. These labor costs are accumulated by means of the job time tickets which bear the same number as the job they pertain to. Each day's total of labor cost as thus reported by the job tickets is entered in the cost sheet for the particular job.

Apportioning a Part of the Factory Overhead to a Production Order.—To determine the total cost of manufacturing a certain lot of goods, a portion of the general factory expenses must be added to the direct material and direct labor cost. These general or overhead expenses, which are not directly applicable to any particular manufacturing job, are first collected into a single general "Manufacturing Expense" or "Factory Expense" account. The total is then distributed, or applied to the various jobs that were in process during the period in which the expenses were incurred. There are several methods or bases for making this distribution or application, and this is one of the major problems of manufacturing cost accounting. The columns headed Machine Hours and Factory Expense in form on preceding page are simply for the purpose of applying one of these methods.

Finding the Unit Cost of Manufacture.—On the cost sheet for a particular job, a portion of the overhead is added to the costs entered on it for materials and labor. This total represents the cost of manufacture for the particular lot of goods, as shown in the form on page 314. Dividing the number of units produced on the order into the total cost gives the cost of each unit. This information is useful for the management in controlling costs of manufacture or in determining the selling prices of goods manufactured. The systematic procedure for determining the cost per unit of the commodity manufactured as explained above is in substance cost accounting.

GENERAL LEDGER ACCOUNT FOR COST OF GOODS IN COURSE OF MANUFACTURE

Job or Work in Process Ledger—Goods in Process Account on General Ledger—Procedure in Making Postings—Goods in Process on the Balance Sheet

Goods in Process Account.—The detailed cost-assembling sheets for the various production orders that are being manufactured at any one time constitute together a subsidiary ledger, called the job or work in process ledger. These detailed accounts for manufacturing costs should be interlocked with the general ledger by means of a control account which will contain a summary of the details posted on the job ledger. On the general ledger this summary is usually shown in Goods in Process account, and when the postings to it are completed, it shows the total amount of manufacturing costs which have to date been incurred on all production orders in process.

Posting Current Manufacturing Cost.—The debits to the Goods in Process account are made by monthly totals as follows. The account is debited for all materials used directly in manufacturing. This figure is the total of the "Direct" column in the requisition journal. During the month the individual cost sheets received the same postings in detail directly from the requisition orders. Likewise, at the close of the month, the Goods in Process account is debited for the total cost of labor directly expended in manufacture during the month. The posting is the total of the Labor in Process column in the voucher register, when the register is summarized at the end of the month. The entries in this column were based on vouchers, which were prepared from the weekly payrolls, which in turn were prepared from the daily time tickets of the workmen. (See page 304.) On the other hand, the detailed charge for labor entering directly into manufacture, made to the individual accounts or cost sheets comprising the job ledger, came directly from the job time tickets. Finally, the total factory expenses incurred during the month have been assembled in the Factory Expense control account in the general ledger. (See page 310.) This account is closed out into the Goods in Process account, which now contains all the charges for cost of manufacture during the month. At the same time, the total of the Factory Expense account is distributed among the various production orders or cost sheets, constituting the job ledger, in order that these may likewise contain at the close of the month all the manufacturing costs, including factory overhead.

Goods in Process as One of Three Inventory Items on Balance Sheet.—It will, therefore, be noticed that the total of the debits in the Goods in Process account should equal the sum of the charges made on the individual cost accounts in the job ledger—the cost sheets. This Goods in Process account is one of the three accounts which constitute the inventory of a manufacturing enterprise. Another inventory account represents Materials which are still in the storeroom and have as yet not entered the manufacturing process. That is, they have not as yet become goods in process. The third inventory account is Finished Goods. Thus, the three manufacturing inventory accounts merely represent the three stages which materials or goods pass through in the manufacturing process. On the balance sheet they will usually appear as separate items.

Very frequently, instead of a single Goods in Process control account on the general ledger, three accounts are set up: (1) Materials in Process, to receive the postings for the cost of all materials entering directly into manufacture of individual production orders; (2) Labor in Process, to receive the postings for the cost of all labor directly expended on individual production orders; and (3) Factory Expense in Process, to receive the postings for general factory expense incurred and distributed over the various production orders. In the balance sheet these three accounts are usually combined into the one item of Goods or Work in Process.

FINISHED GOODS

Running Inventory of Finished Goods—Finished Goods Control Account—Showing Amount of Finished Goods on Balance Sheet

Finished Goods Ledger.—As goods in the factory are finished, they are put into the stockroom until shipped out on selling orders. Meanwhile, however, a record must be kept of the quantities and also of the total cost incurred in their manufacture. For this purpose, a finished goods or stock ledger is kept. It consists of a file of cards, similar to those used for recording the various kinds of raw materials in the materials ledger. (See form on page 300.) A separate card is used for each kind of article manufactured. As goods are completed by the factory and delivered to the stockroom, an entry is made in the Received column of the proper card. The clerk in charge of the finished stock ledger secures the information as to the cost of the goods from the clerk in charge of the cost sheets. When goods are shipped on order or are issued for other purposes, the stock clerk makes an entry in the Issued column on the stock card to show the quantity shipped and its cost. The amount of goods on hand at any time is shown in the Balance column.

Finished Goods Control Account.—Meanwhile a Finished Goods control account is kept on the general ledger to receive summary postings for all goods delivered to the stockroom and for all goods shipped or otherwise issued out of the stockroom. When the manufacture of a particular lot of goods is completed, it is turned into the stockroom. An entry is made, either in the general journal or in the special finished goods journal, crediting Goods in Process and debiting finished Goods. The amount for this entry is the total cost of manufacturing that particular lot, as shown by the cost sheet for those goods. At the close of the month, the columns of the journal are summarized, and the total is posted in the general ledger to the debit of Finished Goods account and to the credit of Goods in Process account. The routine of recording cost of finished goods is illustrated on the following page, though here the cost of Goods in Process is divided into three component accounts: Materials in Process, Labor in Process, and Factory Expense in Process.

FLOW OF COST OF FINISHED GOODS

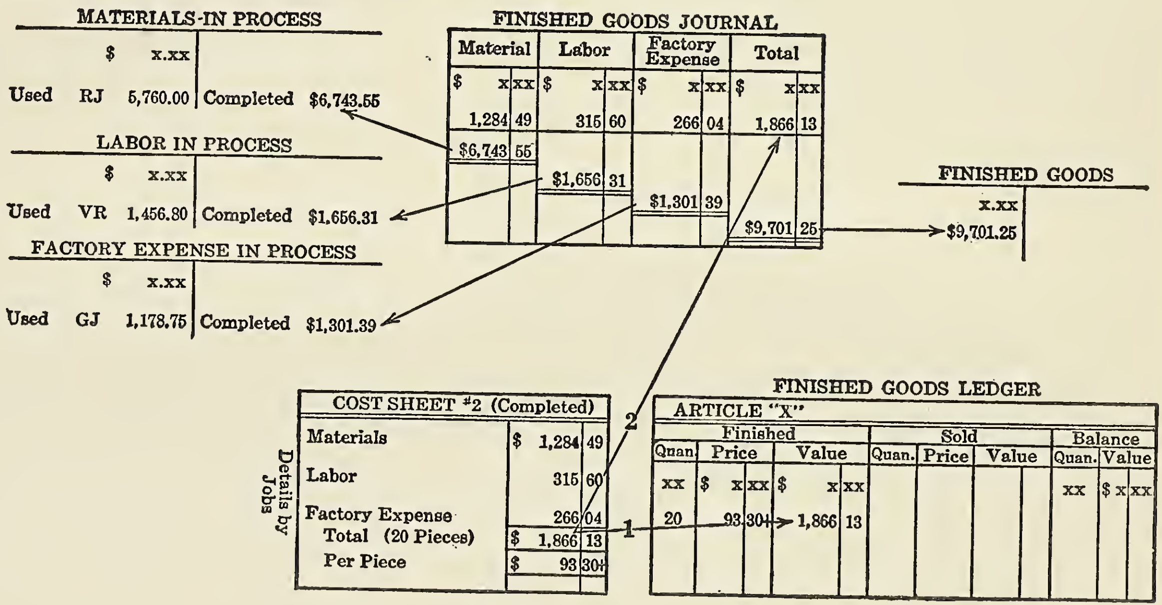


Diagram Illustrating Recording of Cost of Finished Goods

When the goods are sold and shipped out of the stock-room, the Finished Goods account is credited with the cost of the shipment, while Cost of Goods Sold account on the general ledger is debited. (See below on this page.)

It will be observed that if the entries are correctly made, the balance of the Finished Goods control account on the general ledger, when fully posted, will always equal the total amount of finished goods in stock as shown by the finished goods ledger, and both should open with the physical inventory that is made periodically of finished goods in stock.

Finished Goods Account on the Balance Sheet.—The Finished Goods control account is one of the three items comprising the inventory of manufacturing establishment. The other two are Materials and Goods in Process. Each may be set forth separately on the balance sheet, or all three may be combined into the one item of Inventories.

COST OF GOODS SOLD ACCOUNT

Entries Made in the Account—Purpose Served—Entries to Record a Sale of Manufactured Goods—Special Ruling of Sales Journal

Cost of Goods Sold Account Defined.—As the title indicates, the Cost of Goods Sold account is set up to collect in one account the cost of all lots of manufactured goods as they are sold. The complete entry in each case is a debit to this account and a credit to Finished Goods account. The use of the Cost of Goods Sold account presupposes that a record is kept of the manufacturing unit costs for each type of finished goods in stock; that is, that the business has in operation the perpetual, or book inventory. Such an inventory simply means that a formal bookkeeping record is made of the quantity and unit cost of each kind of goods made and carried in stock. One advantage of the Cost of Goods Sold account is that it makes possible the ascertainment, without the necessity of a physical inventory, of the margin of profit (or loss) on the aggregate sales, which is the difference between the net amount received for the goods and their cost.

Absence of Cost of Goods Sold Account on Books of Trading Concern.—In the ordinary trading or merchandising business, no attempt is made to keep a continuous record of the quantity and unit cost of the various types of goods that make up the stock of merchandise or the inventory. The procedure is to charge one account, called Purchases, with the cost of all merchandise bought during the accounting period. When a sale is made of certain items, their individual cost figures are not available, so that it is impossible to ascertain the profit on the sale, and hence there can be no immediate Cost of Goods Sold account. The cost of goods sold and the profit (or loss) can only be ascertained when a physical inventory is taken to find out what quantities of goods are on hand and their cost or value. This total value subtracted from the sum of the inventory at the beginning of the period and the purchases made during the period gives the cost of the goods that have been sold during the period. This cost deducted from the total sales gives the gross profit for the period, from which must be deducted selling and general expenses in order to arrive at the net profit.

Need of the Account in a Manufacturing Business.—While this system suffices for the trading concern with its comparatively simple organization and operations, in a manufacturing business with a more elaborate and complex organization and heavier investment of capital, it is necessary to maintain closer control over the operations, so as to be able to see at frequent intervals how efficiently from a profit-making standpoint the affairs are being conducted. For this reason well-managed manufacturing companies keep detailed records of the cost of manufacturing so that when a particular lot of goods is sold the cost of materials, labor, and general factory expense, and the margin of profit are immediately known. Any tendency for the costs to rise and reduce the margin of profit on individual sales calls for immediate investigation of the cause and its correction, if at all possible.

Two-fold Entry to Record a Sale of Manufactured Goods.—In a trading concern when a sale is made it gives rise to only one entry—a debit to Accounts Receivable for the invoice amount of the sale (including the particular customer's account in the subsidiary ledger) and a credit to Sales. In a manufacturing concern which maintains a perpetual quantity and cost record of all individual goods manufactured, a sale of finished goods causes two entries—first, a debit to Accounts Receivable and a credit to Sales for the invoice amount of the sale; and second, a debit to Cost of Goods Sold account for the manufacturing cost of the particular goods sold as ascertained from the stock ledger (see page 318), and a credit of the same amount to the Finished Goods control account on the general ledger. A credit is also made to the detailed accounts which make up the finished goods ledger. The routine of making this entry is indicated by the diagram on the following page. When goods sold are taken from the manufactured stock, a duplicate is made of the sales invoice, on which is shown, in addition to the sales price of the goods, the unit cost and total cost as obtained from the appropriate card of the stock ledger. The sales journal rulings show two columns—one for entering the cost of sales and the other for the selling price of the goods. Both of these entries are made from the duplicate sales invoice. The column containing the selling prices is posted in the usual manner—during the month, debits to the individual accounts in the customers ledger, and at the close of the month, a debit for the total of the column to Accounts Receivable and credit to Sales in the general ledger. The

FLOW OF COST OF GOODS SOLD

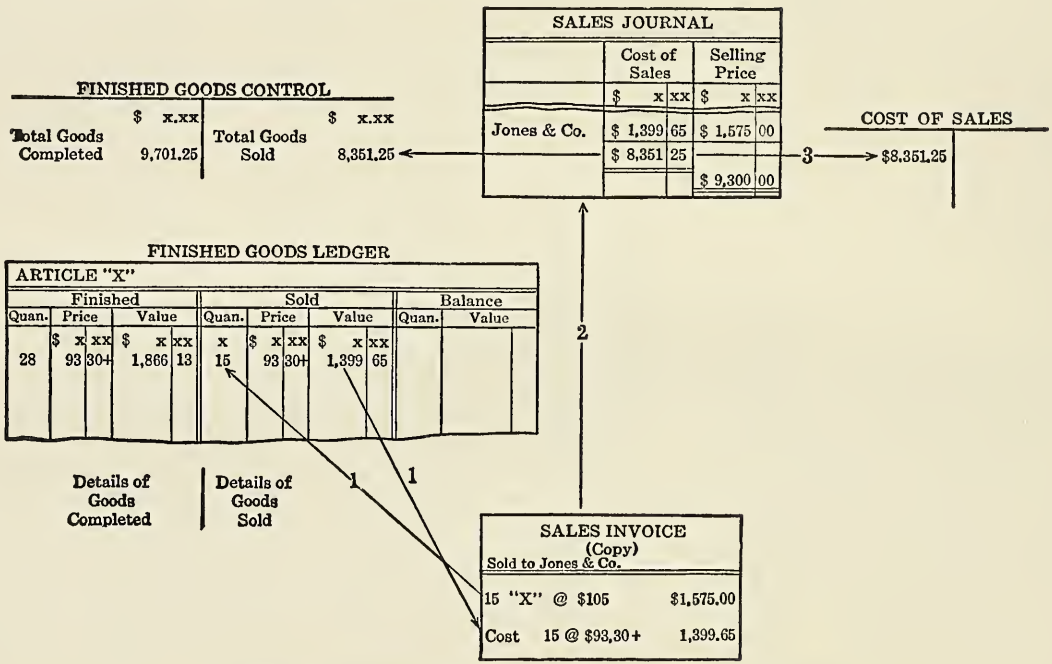


Diagram Illustrating Entries upon a Sale of Finished Goods posting of the items in the cost column is made at the close of the month when the column is totaled. The sum is debited to Cost of Goods Sold account and credited to Finished Goods account in the general ledger.

The entries are, therefore, as follows:

Cost Column of Sales Journal:

Cost of Goods Sold	$4,351.00	
Finished Goods		$4,351.00

Selling Price Column of Sales Journal:

Accounts Receivable	$9,300.00	
Sales		$9,300.00

COST OF MANUFACTURE AND GOODS SOLD STATEMENT

Arrangement of Statement—Prepared Either from Book or Physical Inventory—Percentage Analysis of Statement

General Arrangement of Statement.—The statement of cost of manufacture and goods sold is an analysis of the cost of manufacturing the goods sold during the period covered by the statement, and is prepared in support of the Cost of Goods Sold item in a condensed profit and loss statement. In more or less condensed form this manufacturing statement is at times included in the published form of the profit and loss statement.

The statement may assume various arrangements, but these arrangements are all based on the same principle as exemplified in the cost of goods sold statement of a merchandising concern, an example of which is the following:

Opening inventory, January 1, 19–	$500,000.00
Purchases	400,000.00
Total goods to be accounted for	$900,000.00
Less closing inventory, December 31, 19–	450,000.00
Cost of goods sold	$450,000.00

The only difference between the cost of goods sold statement of a manufacturing concern and that of a merchandising concern is that in the former the inventories consist of materials and supplies, goods in process, and finished goods, and the purchases include cost of labor and factory expense, as well as the cost of materials and supplies; whereas in a merchandising concern the inventories consist of merchandise purchases at practically invoice value.

Contents of Statement.—The following page shows one form of the manufacturing statement. The statement actually consists of two sections, the first concluding with the Cost of Goods Manufactured, and the second with Cost of Goods Sold. In organizations which accumulate manufacturing costs on their books, the cost of goods manufactured and cost of goods sold is obtained directly from the records instead of by the inventory methods as discussed above. But as errors creep into the operation of every cost system and unrecorded losses are bound to occur, physical inventories must be taken as a check on the records. The form of manufacturing statement illustrated gives the costs for the organization as a whole. For purposes of internal control, other statements may be prepared to show the costs for each plant, department, or product.

Note that the first part of the statement which sets forth the cost of goods manufactured is drawn in three sections: (a) materials, (b) labor, and (c) factory expense. Each of these sections is an analysis of the work in process account for which it is named. The amount column shows the amount of each element comprising cost of goods manufactured, and the percentage column shows the ratio of the cost of each element to the total. These percentages are significant. If the material percentage rises, waste of materials or rising prices may be indicated. The same facts are indicated with reference to labor and factory expense.

JOHNSON MANUFACTURING COMPANY
STATEMENT OF COST OF GOODS MANUFACTURED
For the Month of January, 19–

Particulars		Amount	% of Total
DIRECT MATERIALS:			
Materials in Process, January 1, 19–...	$1,564.02		
Materials Used	5,760.00		
	$7,324.02		
Less—Materials in Process, January 31, 19–	580.47		
		$ 6,743.55	69.51%
DIRECT LABOR:			
Labor in Process, January 1, 19–.......	$ 384.15		
Labor Charges to Production..........	1,456.80		
	$1,840.95		
Less—Labor in Process, January 31, 19–	184.64		
		$ 1,656.31	17.07%
FACTORY EXPENSES:			
Factory Expense in Process, January 1, 19–	$ 301.83		
Factory Expense Applied............	1,178.75		
	$1,480.58		
Less—Factory Expense in Process, January 31, 19–......................	179.19		
		$ 1,301.39	13.42%
Cost of Goods Manufactured..................		$ 9,701.25	100.00%
Finished Goods Inventory, January 1, 19–........		$ 1,800.00	
Add—Cost of Goods Manufactured.............		9,701.25	
Total Available for Sale..................		$11,501.25	
Less—Finished Goods Inventory, January 31, 19–..		3,150.00	
Cost of Sales..........................		$ 8,351.25	

Form of Cost of Manufacture and Goods Sold Statement

THE FACTORY LEDGER

Accounts Included—Balancing or Offsetting Accounts—Operation of the Factory Ledger—Preparing Combined Trial Balance

Relation of Factory Ledger to General Ledger.—Manufacturing accounts usually involve a great deal of detail, and for that reason many manufacturing establishments segregate them in a separate book called factory ledger. These accounts include those for materials, labor, and general factory expense or overhead, all of which enter into the cost of manufacturing the product sold. The general factory overhead expenses will include supplies and fuel used in manufacturing, taxes and depreciation in factory buildings, and insurance carried on account of the manufacturing activities. In addition, the factory ledger will include the accounts for work in process and finished goods. The factory ledger is thus but a section of the general ledger transferred to a separate book. It may be kept at the general office where the rest of the general records are located, or it may be kept at the factory office, especially if the factory is located some distance from the general office.

Balancing or Offsetting Accounts.—The factory ledger is tied up or interlocked with the general ledger by means of two balancing or offsetting accounts—one in each ledger. For the accounts which are removed from the general ledger there is substituted on the general ledger one omnibus or catch-all account, which is entitled "Factory Ledger." To offset this account there is opened on the factory ledger an account which is entitled "General Ledger," which in reality represents the accounts remaining on the general ledger. When a transaction is to be recorded which involves a debit to an account in one ledger, and a credit to an account in the other ledger, the entry is two-fold. If, for example, an account in the general ledger is to be debited and an account in the factory ledger is to be credited, the entry is as follows:

On the General Books:	On the Factory Books:
Debit: (Account affected)	*Debit:* General Ledger
Credit: Factory Ledger	*Credit:* (Account affected)

On the other hand, if an account in the factory ledger is to be debited and an account in the general ledger is to be credited, the entry will be as follows:

On the General Books:	On the Factory Books:
Debit: Factory Ledger	*Debit:* (Account affected)
Credit: (Account affected)	*Credit:* General Ledger

It will thus be noted that by means of the two general interlocking or offsetting accounts each ledger, when posted up, is in balance independently of the other ledger. Moreover, the balances of the two offsetting accounts should always be equal, except for any items that may be in transit between the two offices. When the accounts of the two ledgers are combined in one trial balance, these two offsetting accounts will cancel each other out.

In transactions which affect accounts only on the general ledger, or only on the factory ledger, the entries are made as though there were only one ledger, and they will not involve debiting and crediting the offsetting accounts.

Operation of the Factory Ledger.—The general office incurs various liabilities for the factory which it must pay for in cash. Thus, whenever materials are purchased for the factory, the general office must pay for them even though the goods are sent directly to the factory. When the factory payroll is made up, the general office must send a check for the amount to the factory. The general office also usually pays for the many general factory expenses, such as taxes, insurance, fuel, and so on. All of these payments are first recorded in the voucher register at the general office. In this voucher register there is one debit column headed "Factory Ledger" which takes the place of the columns headed Materials, Payroll, and Factory Expenses as they appear in a voucher register where no factory ledger is used. The entry for each expenditure on account of the factory is made by debiting "Factory Ledger" and crediting Vouchers Payable.

Whenever materials are purchased for the factory but are to be paid for by the general office, the following entries are made on the general and factory books:

On the General Books:	On the Factory Books:
Debit: Factory Ledger *Credit:* Vouchers Payable (This entry is made in the voucher register.)	*Debit:* Materials *Credit:* General Ledger (This entry is made in the factory journal.)

When materials are used in production at the factory, entry is made only on the factory books, there being a debit to Work in Process and a credit to Materials control account.

When a check is sent to the factory for the payroll, the entries usually made are as follows:

On the General Books:	On the Factory Books:
	(I) *Debit:* Direct Labor *Debit:* Indirect Labor *Credit:* Payroll Accrued (This entry is made on the factory journal when the payroll is prepared.)
(II) *Debit:* Factory Ledger *Credit:* Vouchers Payable (When the voucher for the payroll check is prepared.)	
(III) *Debit:* Vouchers Payable *Credit:* Cash (When the check is sent to the factory.)	(IIIa) *Debit:* Payroll Fund *Credit:* General Ledger (When the check is received at the factory.)
	(IV) *Debit:* Payroll Accrued *Credit:* Payroll Fund
	(V) *Debit:* Work in Process *Debit:* Manufacturing Expense *Credit:* Direct and Indirect Labor (To close out labor accts.)

In recording the general manufacturing expenses, the procedure varies according to whether or not the expenses involve the payment of cash. If the expenses involve the payment of cash by the general office, the entries will be:

ON THE GENERAL BOOKS:	ON THE FACTORY BOOKS:
Debit: Factory Ledger *Credit:* Vouchers Payable (This entry is made on the voucher register.)	*Debit:* Expense *Credit:* General Ledger (To record payment of expense by general office.)

If the expense consists of a decrease of a prepaid expense already on the general records, the entries will be:

ON THE GENERAL BOOKS:	ON THE FACTORY BOOKS:
Debit: Factory Ledger *Credit:* Prepaid Insurance (To record amount of prepaid insurance and taxes expired.)	*Debit:* Insurance *Debit:* Taxes *Credit:* General Ledger (To record amount of insurance and taxes transferred from general books.)

If the expense is depreciation, the entries will be:

ON THE GENERAL LEDGER:	ON THE FACTORY LEDGER:
Debit: Factory Ledger *Credit:* Reserve for Depreciation (To record depreciation relating to factory assets.)	*Debit:* Depreciation *Credit:* General Ledger (To record depreciation transferred from general office.)

When the foregoing entries for factory expenses are made, all the manufacturing expenses will be on the factory books and will be collected into a summary account, "Manufacturing Expenses," before being closed into Work in Process. This latter account is eventually closed into Finished Goods.

Whenever goods are shipped to the customers from the factory, at the request of the main office, the factory office charges the General Ledger account and credits Finished Goods. On the general books there will be two sets of entries—one of these at the sales price, debiting Accounts Receivable, and crediting Sales; the other, at cost price, debiting Cost of Goods Sold, and crediting Factory Ledger.

Preparing a Combined Trial Balance of Factory and General Ledgers.—The Factory Ledger and General Ledger accounts should always contain balances of the same amount, unless there are items in transit between the two offices, though one will be a debit, and the other a credit. Before preparing the financial statements, one must make certain of this equality, making a reconciliation for any items in transit. When Factory Ledger and General Ledger accounts are thus proved, a trial balance is taken of the general ledger and by eliminating the Factory Ledger account and substituting for it all the accounts on the factory ledger, exclusive of the General Ledger account, a combined trial balance is prepared.

REASON FOR THE ANNUAL DEPRECIATION CHARGE

Assets Which Are Depreciable and Non-Depreciable—Distribution of Depreciation Expense over Life of Asset—How Amount of Depreciation Is Determined

Assets Which Depreciate.—With the exception of land, most so-called fixed or capital assets, comprising the general physical equipment with which an enterprise carries on its business, depreciate in value. Land ordinarily neither wears out nor is scrapped nor abandoned for any other reason. The other fixed assets, including buildings, machinery, and other factory equipment, office fixtures, furniture, and delivery equipment, have a limited useful life, at the end of which they are scrapped and must be replaced with new buildings, new machinery, new fixtures and furniture, new delivery equipment, etc. The necessity for scrapping may be due to various causes, such as ordinary wear or tear, due to use or deterioration, which takes place whether or not the particular asset is being used, and obsolescence, that is, the fact that a particular piece of equipment has become outmoded, and must be replaced by more efficient equipment.

Depreciation as an Expense of Operation.—It is not necessary to know the various causes of this depreciation to realize that sooner or later, for one reason or another, newly acquired equipment will have to be replaced at an additional cost, and that therefore the cost of the assets so replaced is an expense of doing business like any other expense, and must be taken into account when the books are closed and the net profit for the period in question is determined. The important question is just when the charge to current expense for this depreciation should be made. There is only one equitable method and that is to spread the total charge with regard to a particular depreciating fixed asset over the several years of its life, as any other method will distort the record of net profits. It is for this reason that at the close of each accounting year, when the books are closed and the net income is arrived at, a deduction is made from the value at which the asset is carried and charged to expense. If the business is successful and returns a profit at the end of each year, a portion of the original costs or investment in the fixed asset is recovered through the sale of merchandise, or factory product, or the service performed by the concern. Thus, the cash investment in the asset is returned to the treasury in its original form in periodical instalments.

Determining the Amount of Depreciation.—Each year's income in the life of a building, or a machine, or a delivery truck, or any other fixed asset with the important exception of land, must bear, therefore, this charge for a portion of the original cost of the asset. Various methods have been devised for determining what the amount of this annual expense charge for depreciation shall be, but the simplest and the one most widely employed, which is known as the "straight-line method" of depreciation, is merely to take the net cost of the asset and divide it by the number of years it is estimated the asset will prove useful, before it is finally discarded. In other words, the annual charge is one of uniform amount. The net cost is arrived at by taking the original cost of the asset and deducting the amount likely to be realized from the asset when scrapped and sold.

Suppose, for example, a delivery truck is purchased for $3,300, and considering the particular work in which it will be used, it is estimated that in five years it will have to be replaced by a new truck. It is estimated that the old truck when scrapped will be sold for $300. The estimated net cost of the present truck is therefore $3,000, and the amount chargeable at the end of each year of the truck's useful life, to expense for depreciation, will therefore be this net cost divided by 5, or $600.

It will be readily seen that the expense charge for depreciation is not an exactly determined amount, but an estimate made on the basis of previous experience. This may prove to be either too small or too large, depending on, first, whether the useful life of the truck will prove to be less or more than five years; and second, whether the scrap value of the truck will prove to be less or greater than $300. An adjustment may therefore be necessary in the accounts if these estimates should prove to be incorrect. Such adjustments have to be made usually, since it is impossible to make exact estimates of the amount that should be charged periodically to depreciation.

Rates of Depreciation.—In applying rates of depreciation in a large plant, it is not practicable to consider every piece of property separately. Usually the plant equipment is divided into groups of similar assets according to estimated life, operating conditions, climate, usage, methods of upkeep, etc., and a composite rate is applied to the group. A rate of 5% means that 5% of the value of a particular asset is written off each year for depreciation. Typical annual group rates frequently used are:

Group	%	Group	%
Buildings:		Dynamos	5
Dwellings—frame	3	Engines	10–12½
Tenement houses......	5	Furniture and fixtures...	10
Brick	2½	Horses	20–30
Reinforced concrete ...	2	Steel bridges	2–5
Paving and pavement....	4–10	Steamboats	6
Automobiles	20–25		

RECORDING DEPRECIATION

Illustration of Adjusting Entry for Depreciation at Closing—Method of Showing Depreciation in the Balance Sheet

Depreciation Reserve Account.—At the end of each accounting period when the adjustment entries are made and the books are closed to arrive at the net results for the period, the periodical loss in the value of each class of fixed or capital assets, due to depreciation, must be set up on the books as one of the adjusting entries. This can be done by debiting General Expense, or the special account of Depreciation Expense, and crediting the asset account. However, it is not the practice to post the credit directly to the fixed asset account, since it is desirable to keep the original cost price a separate and distinct item. A subsidiary account known as the Reserve for Depreciation, or Allowance for Depreciation, is opened instead and the credit is posted to it.

Entries Illustrated.—Assume that on January 2, 1931, a delivery truck is purchased at a total cost of $3,300, and according to the estimate made, it will have a useful life of five years, when it is expected to be sold for about $300. The charge to Depreciation Expense and credit to Reserve for Depreciation of Delivery Truck, made at the end of each accounting period will amount to $600, that is, the net cost of the truck, $3,000, divided by 5. At the end of the five years, the Reserve for Depreciation account will appear as shown in the following account:

Reserve for Depreciation of Delivery Truck, purchased Jan. 2, 1931

						1931 Dec.	31			600	–
						1932 Dec.	31			600	–
						1933 Dec.	31			600	–
						1934 Dec.	31			600	–
						1935 Dec.	31			600	–
										3,000	–

Meanwhile no entry has been made in the asset account, Delivery Truck, set up to record its cost on January 2, 1931 (unless, of course, additional trucks have been purchased). Assume that the truck is sold on the last day of its estimated life, December 31, 1935, for its estimated scrap value of $300; the entry, which is made in the general journal, will be as follows:

Reserve for Depreciation of Delivery Truck.......	$3,000.00	
Cash	300.00	
Delivery Truck		$3,300.00
To record sale of truck.		

The retirement and sale of the truck will close both the asset and the Depreciation Reserve account. On January 2, 1936, when a new truck is purchased for the sum of $3,500, which is to replace the one scrapped and sold, the accounts will appear as follows:

Delivery Truck

1931 Jan.	2	Cost, Truck #1		3,300	–	1935 Dec.	31	Retired		3,300	–
1936 Jan.	2	Cost, Truck #2		3,500	–						

Reserve for Depreciation of Delivery Truck, purchased Jan. 2, 1931

1935 Dec.	31	Retired		3,000	–	1931 Dec.	31	Accrued	600 –
						1932 Dec.	31	Accrued	600 –
						1933 Dec.	31	Accrued	600 –
						1934 Dec.	31	Accrued	600 –
						1935 Dec.	31	Accrued	600 –
				3,000	–				3,000 –

Fixed Asset and Depreciation Reserve on the Balance Sheet.—On the balance sheet the approved method of setting forth the net book value of the fixed asset is to show the deduction of the balance of the Depreciation Reserve account from the original cost of the fixed asset as follows:

Buildings, Machinery, etc.		
Original Cost	$50,000.00	
Less: Reserve for Depreciation	15,000.00	
Depreciated Value		$35,000.00

Sometimes only the amount after the deduction is exhibited on the balance sheet. Showing the balance of Depreciation Reserve account in the liability column of the balance sheet is not considered the best practice by accountants.

FIXED ASSET REGISTER

Record of Office Furniture and Other Office Equipment—Numbering and Tagging Separate Pieces—Loose-Card Equipment Record

Function of Fixed Asset Register.—This register forms a convenient record of miscellaneous fixed assets of comparatively small value and simple nature, such as pieces of office furniture and other office equipment. One form of the fixed asset register is shown below.

Date	No.	Description	Cost	Scrap Value	No. of Years	Rate	Depreciation	
							Year	Amount

(left page)

Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Carried Forward	Disposition

(right page)
Fixed Asset Register

For purposes of identification and record, each piece of equipment should be given a serial number and a metal tag bearing the number attached to it. This number as well as a description of the property should be entered in the fixed asset register. In addition, the register is ruled to show the original cost of each property, the estimated scrap value, the number of years it is estimated the fixed asset will be serviceable, and the annual rate of depreciation and amount of depreciation which should be debited to depreciation expense and credited to Depreciation Reserve. Columns may also be provided to show the monthly depreciation if that is desirable, and the accumulated depreciation carried forward since the acquisition of the asset. The final disposition of the piece of property, whether by sale or outright scrapping, may be indicated in the final column. Separate pages of the register should be used for each type of asset for which a separate depreciation reserve account has been set up.

Record of Book Value of Fixed Assets.—Where the fixed asset register is used, no plant ledger is needed. An advantage of the register is that the book value of each asset can be readily ascertained from it. The book value is the original cost less all recorded charges for depreciation, and is a useful figure when the fixed asset is sold, exchanged, or scrapped. It is also useful in preparing income tax schedules. In making monthly charges to the Depreciation Reserve account for a particular group of fixed assets, the total of all the monthly charges is entered in the Depreciation Reserve account as a single figure.

Loose-Card Office Equipment Record.—In lieu of a register the detailed record of office furniture and other office equipment may be kept in a loose-card file, one card being devoted to each piece of furniture or equipment. A convenient form of such card is shown below. Space is provided in the card for the metal tag number of the piece of furniture or equipment, a description of the piece of furniture or equipment, the maker's number, the name of the vendor, date of purchase, its cost and estimated life, the annual depreciation

The BLANK COMPANY

EQUIPMENT RECORD

NO.__________

Description______________________________

________________Maker's No.__________

Vendor ____________________Date__________

Cost________________Estimated Life__________

Depreciation Per Annum Rate________Amount__________

Depreciation				
Year	Amount	Year	Amount	Used in________Dept.
				Trans. to________Dept.
				Trans. to________Dept.
				Trans. to________Dept.
				Sold to________
				Destroyed________
				Disposition No.________

Equipment Record

rate and amount, the charges to be made over a series of years, the department in which the piece of equipment is being used, and its final disposition if no longer used.

PLANT LEDGER

Function and Form of Plant Ledger in Manufacturing Concern —Information Ledger Should Contain

Need of Plant Ledger.—The plant ledger contains accounts with various groups of fixed assets, comprising the plant and equipment with which the manufacturing concern operates and does business. These consist of land, buildings, machinery, fixtures, horses, trucks, and other delivery equipment. In a small business, these assets may be classified only

Ledger Account ________________ Sheet No. ________

Name and Description ________________ Location ________

________________ Manuf. Serial No. ________

________________ Manuf. Motor No. ________

Manufacturer ________________ Asset No. ________

Purchased from ________________

Date Purchased ________ Estimated Life ________ Years

Date Installed ________ Rate of Depreciation ________ %

Date Disposed of ________

Disposition Made ________

Invoice Reference ________

Remarks ________

INITIAL COST	AMOUNT
Invoice Price	$
Transportation, Trucking, Handling	
Extra Equipment	
Installation Cost	
Total	

Date	Items	Cost	Year	Depreciation	Reserve for Depreciation	Net Value	Disposition of Assets		
							Date	Amount	Remarks

Plant Ledger

according to their nature in a number of accounts in the general ledger. However, where the business is a large one, and the number and value of these assets is considerable, a subsidiary record known as the plant ledger, or register, is kept to show the detail of the group asset accounts carried on the general ledger. Such detailed records are necessary in order to maintain an adequate check on the assets, and also to show their loss of value through wear and tear, decay, and other causes of depreciation. They are also useful in showing values for insurance and income tax purposes.

Form of Plant Ledger.—The form of this plant ledger varies. It may consist of loose leaves bound together, a page being given to each fixed asset; or it may consist of a file of cards with a card for each asset. The pages or cards may be ruled for entry of the kind of information desired with reference to the various classes of assets. Thus, the subsidiary machinery record may consist of a number of cards or pages, one for each machine, containing the following data: (1) name of the asset; (2) the number given it; (3) its location; (4) name of the manufacturer of the machine; (5) from whom purchased; (6) when installed; (7) invoice price; (8) other costs, as those of installation; (9) estimated life of the machine, the annual rate of depreciation, and the entire depreciation history to date of the asset; (10) information regarding ordinary and extraordinary repairs, etc. A form of plant ledger is shown on page 340.

SALE OR RETIREMENT OF FIXED ASSETS

Temporary Nominal Account Set Up to Record Profit or Loss on Sale—Illustration of Entries When a Depreciating Asset Is Retired

Sale of Land.—When unimproved land is sold by a business concern, Cash is debited with the proceeds and the Land account is credited through the cash receipts book with amount received. The Land account is then closed out by a general journal entry. If it has a credit balance showing a profit on the sale, the account is debited with the amount of the balance to close it and a temporary nominal account carrying an appropriate title, such as Profit from Sale of Land, is credited. If the Land account has a debit balance, showing a loss on the sale, a temporary account entitled "Loss on Sale of Land" is debited with the amount of the balance and the Land account is credited. At the end of the accounting period, the temporary account is closed out into Profit and Loss.

Retirement of Assets Subject to Depreciation.—Where a fixed asset is subject to depreciation, the bookkeeping entries for its retirement by sale or outright scrapping or destruction are more complicated. Not only is the account in which the asset is recorded affected but also the Depreciation Reserve account in which the periodical entries for losses in its value due to depreciation have been made.

Assume for example, that a motor truck was purchased originally for $3,200. This amount was entered as a debit to the Truck account. A Depreciation Reserve account was opened to receive annual credits of $600, it being estimated that the truck would have a useful life of five years, and could then be sold for $200. The truck is sold at the end of four years for $400. At this time the accumulated depreciation in the reserve account amounts to $2,400. The record of the sale is as follows:

(1) Cash	$ 400.00	
Truck		$ 400.00
To record sale of truck.		
(2) Depreciation Reserve	$2,400.00	
Truck		$2,400.00
To close out Reserve for Depreciation account into asset account.		
(3) Loss on Sale of Truck......................	$ 400.00	
Truck		$ 400.00
To record loss on sale of truck.		

(4)	Profit and Loss............................	$ 400.00	
	Loss on Sale of Truck.................		$ 400.00
	To close into Profit and Loss.		

If after the second entry the asset account has a credit balance, the sale of the truck would have resulted in a gain. The third and fourth entries would then be as follows:

(3)	Truck	$200.00	
	Profit on Sale of Truck...................		$200.00
	To record profit on sale of truck.		
(4)	Profit on Sale of Truck.........................	$200.00	
	Profit and Loss...........................		$200.00
	To close into Profit and Loss.		

REPAIRS, REPLACEMENTS, AND RETIREMENTS

Repairs as a Current Operating Expense—Illustration Showing the Handling of Replacements and Retirements

These terms refer to expenditures made in keeping the plant and equipment of a business establishment in good working order. The chief bookkeeping problem involves the treatment of the charges for the expenditures, as an improper treatment results either in an understatement or an exaggeration of the profits for the year.

Treatment of Repairs.—As the term is commonly used, repairs refer to the minor upkeep charges, which can be counted on to amount to a certain more or less uniform sum year in and year out. These ordinary expenditures are proper charges to current operating expense accounts.

Replacements and Retirements.—When the expenditures are extraordinary in amount, as when a part of an expensive machine is retired and replaced with a new part, or when the entire roof of a building is replaced, repairs of this nature require a bookkeeping treatment quite different from ordinary repairs. It would be unfair for the year in which they occur to make it bear their entire expense, and so the total expense is distributed over a number of years. The bookkeeping handling of such heavy non-recurring repairs is as follows.

An estimate of the original cost of the part retired must first be made, if it was not bought as an individual unit. That cost should be debited to the Depreciation Reserve account and credited to the account for the asset from which the part is being retired. The cost of the new part is debited to the asset account. Thus, if a building cost $30,000, and its roof is being replaced, it is necessary to estimate the original cost of the roof if there is no separate record of it. If that estimate places the cost at $2,500, the Depreciation Reserve account for the building is charged and the Building account credited with that amount, the entry being made in the general journal. The cost of the new roof, say $3,000, is charged to the Building account and credited to Cash through cash disbursements journal or check register. Depreciation is henceforth based on the new asset account balance.

ADDITIONS AND BETTERMENTS TO FIXED ASSETS

Additions, Betterments, and Improvements Defined—Cost Debited to Account of Property Affected

Additions to fixed assets are, as the term implies, buildings and other structures, machinery, and other equipment added to those already in service and not taking the place of any of like purpose. Betterments and improvements are physical changes in buildings and other structures, machinery, and other equipment which aim primarily at making these assets more useful or of greater capacity than they were at the time of their installation or acquisition. Expenditures for such additions, betterments, and improvements should be debited to the asset account affected and should not be charged to current operating expense.

RESERVE FOR DEPLETION

Depletion Defined—How the Loss from Depletion Is Computed —Recording Depletion—Showing It on the Balance Sheet

Natural Resources Subject to Depletion.—Depletion in accounting refers to the diminution in the value of certain natural resources purchased and worked by a business, such as timber tracts, mines, quarries, and oil wells. These natural resources are carried in the books at cost, in the same manner as land, buildings, and other fixed assets. However, as they are worked and become depleted, the resulting loss in their value must be shown in the books. While this loss from depletion is different in its cause from the loss by the depreciation of such fixed assets as buildings and machinery, which are subject to wear and tear, its effect on the accounts is similar to the loss from depreciation and its bookkeeping treatment is no different.

Computing Loss from Depletion.—A natural resource is ordinarily worked for a period of years, but it is necessary to ascertain its annual or other periodical loss for entry in the books. The manner in which this is done is illustrated in the following example. Suppose a coal mine is purchased for $105,000, and it is estimated that the value of the surface land after the exhaustion of the mine will have a value of $5,000. When the mine is completely worked out, the total loss of value will be the net cost of the mine land, or $100,000. The next step is to estimate the amount of coal that is probably recoverable from the mine. This is a problem with which the accountant or bookkeeper is little concerned. The answer to it is furnished by mining and geological experts. Suppose their estimate places the amount of recoverable coal at 400,000 tons. It may, therefore, be said that the company has purchased for $100,000 net, 400,000 tons of coal deposits, or at the rate of $.25 a ton. With every ton mined, therefore, the mine will decrease $.25 in value and the amount should be deducted from its original cost.

Entries to Record Depletion.—The deduction, however, is not made directly by crediting the account for the coal mine. Instead, a separate account, Reserve for Coal Mine Depletion, or Allowance for Coal Mine Depletion, is opened to receive the credit. The offsetting debit is to an expense account called Depletion. If, therefore, during the first year a total of 20,000 tons are mined, resulting in a loss in mine value of $5,000 (20,000 times $.25), the entry is as follows:

Depletion	$5,000.00	
Reserve for Coal Mine Depletion..........		$5,000.00
To record annual depletion of coal mine.		

A similar entry will be made for each successive year or other accounting period taken, the amount in each case depending on the number of tons mined. While this depletion is commonly referred to as a loss, it is in reality a cost of mining, and is included with the other costs of operating the mine in determining the profit or loss for the period.

The Coal Mine account, carried at its original cost of $105,000, and the Reserve for Coal Mine Depletion with its periodical credits, form practically one account. The latter is in reality the credit side of the Coal Mine account. The two should always be associated together. When it is necessary to learn the value of the mine at any time, or its so-called book value, the Depletion Reserve account is deducted from the balance of the Coal Mine account.

Depleted Value of Natural Resource on Balance Sheet.—On the balance sheet the net figure for the depleted value of the coal mine may be shown. It is better practice, however, unless a very condensed form of balance sheet has to be used, to show on the balance sheet the deduction of the amount charged to depletion, as indicated by the balance of the Depletion Reserve account, thus:

Coal Mine:		
Original Cost	$105,000.00	
Less: Reserve for Depletion	22,000.00	
Depleted Value		$83,000.00

DEPARTMENTAL ACCOUNTING IN A MERCANTILE BUSINESS

Purpose Served by Departmental Accounting—Special Columns in Journals—Extent to Which Departmentalization Is Carried

Reason for and Extent of Departmentalization.—A merchandising concern may be operating on a departmental basis. It may be handling several lines of merchandise, and may be organized so that each line is handled by a separate department. Under such conditions it will be desirable to conduct the accounts so as to show the results of operations by departments. The management will want to know results from each department. The account departmentalization will not be carried through the whole length of the accounting books but will be confined to the Purchases and Sales accounts and may possibly also include the selling expense accounts, especially if each department has its own selling organization. There will accordingly be opened on the books separate departmental accounts for Sales and Purchases:

Sales:
- Department A
- Department B, etc.

Returned Sales and Allowances:
- Department A
- Department B, etc.

Purchases:
- Department A
- Department B, etc.

Returned Purchases and Allowances:
- Department A
- Department B, etc.

Departmental Columns in Special Journals.—In the several special journals concerned with sales and purchases, including sales and purchase returns and allowances, there will be separate money columns for each department. In the sales journal, for example, there will be separate columns for Departments A, B, etc., as shown in form below. There will also be a column for entering the total amount of each sale, irrespective of whether it comprises commodities handled by several departments. The daily postings to customers' accounts will be made from this column, and its total at the end of the month will be posted to Accounts Receivable controlling account on the general ledger. The purchase journal will have similar columns in which to enter the purchases made for the several departments, and if there are special journals for sales returns and allowances, and for purchases returns and allowances, these will have the same rulings.

Date		Name	Inv. No.	L F	Debit	Credit	
					Accounts Receivable	Sales Dept. A	Sales Dept. B
19—							
June	8	E. K. Ross	221		1,000 00	500 00	500 00
	10	T. A. Hardy	223		550 00	50 00	500 00
	15	H. R. Thomas	224		200 00	125 00	75 00
	21	R. T. Taylor	225		1,850 00	50 00	1,800 00
					3,600 00	725 00	2,875 00
					(4)	(23)	(35)

Sales Journal Columnarized to Show Sales by Departments

Ruling of the Cash Book.—In the ordinary business, not divided into departments, the cash receipts book may have a separate column for cash sales, and the cash disbursements book may have a separate column for cash purchases. When there are several departments, a cash sales column in the cash receipts book and a cash purchases column in the cash disbursements book is used for each department.

	Total		Dept. A		Dept. B	
Gross Sales		$29,000.00		$18,500.00		$10,500.00
Deduct Returned Sales and Allowances		880.00		300.00		580.00
Net Sales		$28,120.00		$18,200.00		$ 9,920.00
Deduct Cost of Loads Sold:						
Purchases	$ 8,480.00		$ 6,240.00		$ 2,240.00	
Freight-in	180.00		130.00		50.00	
Total	$ 8,660.00		$ 6,370.00		$ 2,290.00	
Deduct Returned Purchases and Allowances	720.00		540.00		180.00	
Net Purchases	$ 7,940.00		$ 5,830.00		$ 2,110.00	
Inventory—January 1, 19–	2,200.00		1,200.00		1,000.00	
Total	$10,140.00		$ 7,030.00		$ 3,110.00	
Deduct Inventory—December 31, 19–	2,130.00	$ 8,010.00	980.00	$ 6,050.00	1,150.00	$ 1,960.00
Gross Profit on Sales		$20,110.00		$12,150.00		$ 7,960.00
Deduct Selling Expenses:						
Store Rent	$ 1,800.00		$ 600.00		$ 1,200.00	
Advertising	880.00		530.00		350.00	
Delivery Expense	1,260.00		150.00		1,110.00	
Salesmen's Salaries	2,540.00		240.00		2,300.00	
Depreciation of Delivery Equipment	80.00		20.00		60.00	
Total Selling Expenses		6,560.00		1,540.00		5,020.00
Net Profit on Sales		$13,550.00		$10,610.00		$ 2,940.00
Deduct General Expenses:						
Office Salaries	$ 1,200.00					
Insurance	120.00					
Miscellaneous General Expenses	580.00					
Bad Debts	50.00					
Total General Expenses		1,950.00				
Net Profit on Operations		$11,600.00				
Add Other Income:						
Discount on Purchases	$ 480.00					
Interest Income	50.00					
Total Other Income		530.00				
Net Profit on Operations and Other Income		$12,130.00				
Deduct Other Expenses:						
Discount on Sales	$ 340.00					
Interest Expenses	150.00	490.00				
Net Income		$11,640.00				

Profit and Loss Statement of Departmentalized Business

Departmentalizing Selling Expense.—When each department maintains its own selling organization, separate departmental selling expense accounts will be kept. Usually, however, one selling organization will serve all departments, and there will, therefore, be only one set of selling expense accounts for the business as a whole. Nevertheless, it may be desirable to apportion these selling expenses among the several departments on some equitable and fair basis in order to ascertain the selling profit of each department, that is, the profit after the deduction of purchase costs and selling expenses. These expense items are apportioned by different methods. Thus, the amount of rent paid may be divided among the several departments on the basis of the floor space occupied by each department, advertising expense on the basis of advertising space devoted to each department, etc.

Departmental Profit and Loss Statement.—When the profit and loss statement is prepared, there will be a columnar arrangement to show the total as well as the departmental sales, costs, expenses, and profits. The accompanying form sets forth such a departmental profit and loss statement, the departmentalization being carried through selling expense but not to include certain items of general income and expense.

INSTALMENT SALES

Realized and Unrealized Income from Instalment Sales—Book Entries under Instalment Method of Recording Sales—On the Balance Sheet

Nature of an Instalment Sale.—Sales of certain merchandise, such as furniture, radios, pianos, sets of books, and other goods sold at retail at fairly high prices, are frequently made on terms, as expressed in a formal written contract, calling for a small "down" payment and the balance in equal monthly payments over a period of a year or longer. Such sales are called "instalment sales." When they are made, the seller usually protects himself against possible loss through default in payment of the instalments by one of the following plans:

1. He merely leases the goods until the instalment payments are completed, retaining the legal title.
2. He takes a mortgage on the goods, a so-called chattel mortgage, which, being on personal or movable property, is distinguished from a mortgage on real estate.

Realized and Unrealized Income from Instalment Sales.—Instalment sales require special accounting treatment. In ordinary sales of merchandise on credit, the entire gross profit, or the difference between the selling price and the cost of the goods sold, is considered realized profit. In the case of instalment sales, the payments of which are distributed over a relatively long period of time, it is incorrect from a practical viewpoint to treat the entire gross profit on a sale as realized when the sales contract is signed. The purchaser may default on the subsequent instalments, and as the article sold is subject to rapid deterioration, the seller may find that even when he repossesses the article, he has sustained a net loss on the transaction. It is, therefore, better practice to consider as realized profit when the books are closed at the end of the year, only the proportion of the gross profit on each sale which the total collections to date bear to the sales price.

Suppose that on September 15, a dealer sells on the instalment plan for $600 an article the cost of which was $420. The gross profit on it is, therefore, $180. A down payment of $60 is made on delivery, and the balance of $540 is to be paid in 27 equal monthly payments of $20 each. When the books are closed on the following December 31, three such instalment payments have been made, for a total of $60, which added to the original "down" payment of $60, makes the total collections $120, which is 20% of the selling price of \$600. Accordingly, the amount of the gross profit realized on December 31 is 20% of \$180, or \$36. The amount of gross profit unrealized is the remainder of \$144.

Book Entries under Instalment Basis of Recording Sales.—Under the instalment method of recording the sale and collections, the entries are as follows.

On September 15, when the sale is made, the following entries are made:

(1) Instalment Accounts Receivable................	\$600.00	
Instalment Sales		\$600.00
Sale of article under instalment contract on September 15, 19–.		
(2) Cash	\$ 60.00	
Instalment Accounts Receivable...........		\$ 60.00
To record down payment.		

An entry similar to No. 2 above is made upon the receipt of each instalment payment, on October 15, November 15, and December 15.

On December 31, when the books are closed, the following entries are made to record the total gross profit of \$180 on the sale, and to segregate the realized portion of \$36, which is credited to Profit and Loss, from the unrealized portion of \$144.

(1) Cost of Instalment Sales........................	\$420.00	
Purchases		\$420.00
To set up cost of instalment sales.		
(2) Instalment Sales	\$600.00	
Cost of Sales...........................		\$420.00
Unrealized Profit on Instalment Sales......		180.00
To close out sales and cost of sales, and set up total gross profit.		
(3) Unrealized Profit on Instalment Sales...........	\$ 36.00	
Profit and Loss........................		\$ 36.00
To record realized gross profit based on collections as follows:		

Unrealized gross profit \$180 $\times$ 20% = \$36

When the above entries are posted, $36 of the total gross profit will be on the credit side of the Profit and Loss account, and the remaining unrealized portion of $144 will be a credit balance in the account, "Unrealized Profit on Instalment Sales," from which transfers will be made to Profit and Loss in subsequent periods, as collections are made in the $480 unpaid balance of the selling price.

Instalment Accounting and the Balance Sheet.—The account, "Unrealized Profit on Instalments," is shown on the liability side on the balance sheet, either as a deferred credit (see page 458), or on the asset side as a deduction from the item of Instalment Accounts Receivable. Under the second method, the net figure is the "carrying value" of the accounts receivable, which would be shown on the balance sheet as follows:

Instalment Accounts Receivable	$480.00
Less: Unrealized Gross Profit	144.00
Net Carrying Value	$336.00

GENERAL NATURE OF CONSIGNMENT SALES

Consignment-In and Consignment-Out—Circumstances under Which Consignment More Advantageous Than Sale—Duties of Consignor to Consignee

Definitions.—When goods are shipped to another party to be sold by him for account of the shipper, the transaction is called a *consignment*. The owner, or sender of the goods, is referred to as the *consignor*, and the receiving or selling party, as the *consignee*. From the standpoint of the consignor, the consignment is a *consignment-out*, while from the standpoint of the consignee it is a *consignment-in*. Those who accept goods for sale on consignment are usually known as *commission merchants* or *factors*, who perform the service of selling for a stipulated commission, usually consisting of a certain percentage of the sales proceeds. They may operate under a specific contract with their principals, the consignors, covering a single consignment, or under some general or permanent arrangement covering all consignments to be made.

Why Consignments Are Made.—Goods may be shipped on consignment to a party, rather than sold to him, for various reasons. Where the fluctuation of market prices are sudden and unpredictable, as in the produce trade, the risk of loss from a sudden fall in prices is so great that dealers are willing to take the goods on consignment only and sell them at the consignor's risk. From the receiver's point of view, also, consignment has the advantage over an outright purchase of not requiring him to tie up his capital while the goods remain on his shelves. Moreover, since he has no stock of merchandise and no liability, therefore, on his books, he is not confronted with the possibility of being thrown into the bankruptcy court because of his inability to pay for them. Then, too, the consignor may be introducing a new product to the market and dealers. The dealers may not care to risk their capital in its purchase until a fairly steady market has been developed.

On the other hand, from the standpoint of the consignor, unless the receiver of the goods is willing and able to pay cash, or his credit is beyond question, he, the consignor, may be unwilling to sell the goods outright, but will prefer to retain title to them by shipping them on consignment. As long as the goods remain unsold, they are his, and he can always recover them. If they are sold, the proceeds belong to him, and the consignor's failure to remit the proceeds will be due not to his insolvency but to sheer dishonesty, the risk of which is ordinarily less than that from insolvency.

Duties of Commission Merchant.—Subject to any specific instructions received from his principal, the consignee, or the commission merchant as he is sometimes called, may conduct the consignment business in the ordinary manner, as though the goods were his own. He is, in other words, expected to exercise the same care in handling the consignment goods as he would in handling his own property. He may sell the consignment goods on credit only if it is the custom of the trade, but he must use ordinary prudence in extending credit, and after granting credit, he must be reasonably diligent in effecting collections. On the other hand, so long as any part of the consigned goods are unsold and in his hands, he must care for them as though they were his own. It is a fundamental requirement of the consignment relationship that the consigned goods or the proceeds from their sale must be kept separate from the commission merchant's own merchandise or funds. Barring specific instructions from the consignor to the contrary, the commission merchant may incur expenses necessary to sell or protect the goods, or effect collection if the goods are sold on account. For such expenses, he has a lien on the consigned goods in his possession, that is to say, he has a right to retain the goods until he is reimbursed by the consignor for his outlay, or else he may sell the goods by taking the proper legal proceedings. He is similarly protected in case the consignor fails to pay him his commission, though he usually deducts the commission when he remits.

ACCOUNT SALES

Accounting for a Consignment Transaction Made to Consignor—Billing Price of Consigned Goods—Selling Price as Basis for Expense Charges

Rendering an Account Sales.—Upon completion of his service in selling goods shipped to him on consignment, the commission merchant must make a strict accounting of his transactions to his principal, the consignor. The usual method of settlement is by means of an account sales rendered to his principal. The account sales is a summarized statement of all transactions connected with a particular consignment of goods. It constitutes the formal accounting for the consignment transaction. It must show the amount or quantity of goods received, the sales made, and the expenses incurred, and the balance remaining, which is the amount due the principal. This amount may be immediately remitted to the consignor or credited to his account, according to the contract between the two parties. The usual form of an account sales is shown below.

ACCOUNT SALES

of fruit received via Seaboard Air Line, from

H. C. CLONEY, BRADENTOWN, FLA.,

to be sold for his account and risk

RENDERED BY GAYNOR & GAYNOR, 21 WHITEHALL ST., NEW YORK, MARCH 5, 19–

19–						
Feb.	2	Received:				
		250 bxs. oranges @ $ 3.75	$937	50		
		100 " lemons @ 4.25	425	—	$1,362	50
		SALES				
Feb.	3	100 bxs. oranges @ $ 4.50	$450	—		
		75 " lemons @ 4.40	330	—		
	5	150 " oranges @ 4.75	712	50		
		25 " lemons @ 5.00	125	—	$1,617	50
		CHARGES				
		Freight & Cartage	$ 50	—		
		Commission 5%	80	88	130	88
		Net proceeds by check enclosed			$1,486	62
		E. & O. E.				

Account Sales

Billing Price of Consigned Goods.—Goods may be billed to the commission merchant at cost, at the current market price, or at some fictitious figure. This billing price does not enter into the commission merchant's accounting. His selling price is the basis of income against which his expenses are charged. The commission merchant may use his discretion in the price he accepts for the goods, unless he is given specific instructions from the consignor as to the price at which he may sell the goods.

ENTRIES FOR CONSIGNMENTS ON CONSIGNOR'S BOOKS

Two Methods of Recording Consignment Transactions—Formal Entry in Books of Account—Memorandum Records

In making consignments, the consignor's chief interest is in the net amount realized from the sale of each consignment in order to determine the relative advantage of consignments over straight sales. For this reason, he keeps a separate account with each consignment, which carries a serial number. Until the goods are sold by the consignee, they are part of the consignor's inventory—not of the consignee's.

First Method of Recording.—There are two ways of recording consignments on the consignor's books. According to one method, the cost of the goods constituting a consignment is transferred from Purchases to another merchandise account, having for its title the words "Consignment-Out," followed usually by the number of the consignment and the consignee's name, as "Consignment-Out No. 4, J. B. Alcott." To this account are also charged all expenses of the consignment, as freight, insurance, etc. The entries are as follows:

Consignment-Out No. 4, J. B. Alcott..............	$1,250.00	
Purchases		$1,250.00
Consignment-Out No. 4, J. B. Alcott.............	$ 40.00	
Cash		$ 40.00
Cartage $25; Insurance $15.		

These are the only entries made until the account sales is received from the consignee. Upon the receipt of the account sales, the Consignment-Out account may either be credited with the net proceeds shown in the account sales, or may be charged with the expenses and credited with the gross proceeds. If the consignee, at the same time, remits cash for the amount of the net proceeds, the Cash account is debited. Otherwise, the consignee's account is debited. At this point the consignor makes the following entry on his books, it being assumed that the consignee's account is charged:

Consignment-Out No. 4, J. B. Alcott..............	$ 175.80	
J. B. Alcott (A Receivable).......................	1,424.20	
Consignment-Out No. 4, J. B. Alcott........		$1,600.00
To credit the Consignment-Out with its sales and charge it with its expenses, including commission and to charge Alcott with the balance due.		

The balance of the Consignment-Out account, at this stage, is either a credit balance if a profit has been made on the consignment, or a debit balance if a loss has been sustained. The Consignment-Out account is now closed by transfer of the balance to "Consignments Profit and Loss" account, by the following entry to continue the example used above, where the Consignment-Out account shows a credit balance:

Consignment-Out No. 4, J. B. Alcott..............	$134.20	
Consignments Profit and Loss..............		$134.20
To transfer the profit on this consignment.		

When the books are closed at the end of the accounting period, the balance of the Consignments Profit and Loss account is transferred in the usual manner to the general Profit and Loss account.

Second Method of Recording.—The second method of recording the consignment-out when shipped is to set up two accounts, which are not a part of the formal double-entry records, but merely memoranda. These are the Consignment and Consignment-Out (or Consignment Sales) accounts which are debited and credited respectively with the invoiced value of the consigned goods. There is no credit to the Purchases account as under the first method. Any expenses incurred are charged to the regular expense accounts instead of to the Consignment account. For handling the consignment shipments no special books are required, original entry being in the general journal. If there are many such transactions, however, a special column in the sales journal or a special consignments-out journal may be desirable.

Upon receipt of the account sales, the regular Sales account is credited either with the net or with the gross proceeds; and the other accounts—as Cash, the Consignee, and Expenses—are debited according to the manner of booking as explained in connection with the first method.

The two memorandum accounts, having served their purpose of calling attention to the fact that some goods have been sent to other markets for sale, should now be canceled by a reversing entry, since the goods have been sold and the record of their sale has been made in the regular Sales account.

ENTRIES FOR CONSIGNMENTS ON CONSIGNEE'S BOOKS

Two Alternative Methods of Making Entries—Entries on the General Books—Recording Consignment Transaction on a Memorandum Book

First Method of Recording.—Two methods of making entries on the consignee's books at the time of receipt of a consignment of goods are used. In the first method, two memorandum accounts, Consignments and Consignments-In, are set up, Consignments being debited for the billed value of the goods received, and Consignments-In being credited for the same item. The purpose of these accounts is merely to set up on the general books a reminder of the transaction.

The entry is as follows:

Consignments	$1,250.00	
Consignments-In		$1,250.00
To set up memo accounts of the receipt of John Doe's goods.		

A third account, John Doe, Principal, is used for current record. This account is charged with the expenses incurred in connection with the consignment and is credited with the sales made therefrom. It is charged also with the consignee's commission. The balance of the account is, at the completion of the sale, the amount due the consignor, Doe. When this is paid, the account is closed by a debit to John Doe, Principal, and a credit to Cash or Notes Payable. So long as the balance is unpaid, the account, John Doe, Principal, shows the consignee's liability to his principal. This is a special kind of liability, that of a trustee, which is indicated by the inclusion of the word "Principal" in the account title. In case of insolvency a portion of the assets equal to the balance of John Doe, Principal's account belongs to John Doe, and unless merged beyond possibility of separation, must be so treated. The entries on the consignee's books during the handling of the consignment are as follows:

John Doe, Principal............................	$ 52.50	
Cash		$ 52.50
Freight, duty, and cartage on Doe's goods.		
Customers	$1,600.00	
John Doe, Principal.......................		$1,600.00
To credit Doe with the sales.		
John Doe, Principal..............................	$ 123.30	
Customers		$ 27.30
Commissions		80.00
Collections Guarantee		16.00
To charge Doe with all expenses.		

When the sale has been completed, the memorandum accounts, Consignments and Consignments-In, are canceled against each other, having served their purpose, the entry being as follows:

Consignments-In	$1,250.00	
Consignments		$1,250.00
To reverse.		

Second Method of Recording.—Under the second method, instead of an entry on the general books, the receipt of the goods is recorded in a blotter or memorandum book of consignments received, in which are entered all essential data, covering the name of consignor, quantity, price, legend or distinguishing marks, etc. Expenses incurred are charged to John Doe, Consignment account on the general books, and Sales are credited to the same account. Settlement is made as with John Doe, Principal, as explained above, except that when the balance is not paid, it frequently is transferred to a simple John Doe, Personal account, where so far as the account title is concerned it loses its character as a trust account and is merged with all other creditors.

ADJUSTMENT OF FIRE LOSSES

Duties of Insured in Case of Fire Loss—Basis of Settlement—Adjustment of Differences—Insurance Company's Liability

Fire Insurance Contract.—A fire insurance policy is a contract on the part of the insurance company to pay for or replace, in part or in whole, any loss to specified property caused by fire. For this protection the insured makes a periodical payment to the company. This payment is called the premium. The policy runs for a stated period, one, three, or five years, after which it must be renewed by the payment of another premium if it is to continue in force. The policy is in effect from noon of date of inception until noon of the day on which it expires. Any damage done to the property by a fire which has broken out before the expiration hour is recoverable from the insurance company. The policy is subject to cancellation by the insurance company if the insured fails to fulfil the conditions named in the policy. The policy may also be forfeited if upon taking out the policy, the insured practiced fraud upon the insurance company by concealing or misrepresenting important facts concerning the property, or by practicing some form of deceit in the claim he has filed for losses sustained.

Requirements in Case of Loss.—When a fire loss occurs, the insurance company is entitled to immediate written notice. The insured is also obligated, when a fire breaks out, to make every effort to extinguish it and protect the property from further damage. That accomplished, his next step is to separate damaged movable property from the undamaged, and to make an itemized inventory of it, giving details of the kind of goods damaged, their physical amount and cost, and the amount of damage claimed in respect to them. The insured is required by the terms of the policy to submit within 60 days after the fire a sworn proof of the loss, which will set forth the facts, or the insured's opinion, regarding the origin and time of the fire, his interest in the property, as well as that of other persons, the cash value of each item destroyed or damaged, the mortgages or other similar encumbrances on the property, other insurance carried on the property, with a description of the policies, and any change in the title to, or use, occupation, or possession of the damaged property since the policy was issued. The insured may also be required to submit to an examination under oath and produce at the insurance company's request any books of account, bills and other vouchers helpful in determining the amount of the damage sustained.

Determination of Amount of Loss.—By the terms of the policy, the insurance company may settle a loss from fire by either paying the cash value of the destroyed or damaged property at the time of the fire, or replacing it with property of like kind and quality. When the damaged property is replaceable, settlement is made on the basis of the cost price. Otherwise, it is made on the basis of the market value of the goods prevailing immediately before the fire. In determining the value of the property, allowance must be made for its depreciated condition, due not only to ordinary wear and tear, but also to loss of value caused by changes of fashions, demand, etc.

Adjustment of Difference.—As soon as the insurance company is notified of the fire loss, it sends an adjuster to examine the damaged property and arrive at some satisfactory basis of settlement with the insured. In case of disagreement, the terms of the policy provide for the appointment of two independent appraisers, one by the insurance company and one by the insured, and these appraisers select an umpire, who acts in case of disagreement between the two appraisers. If the amount of loss arrived at by the appraisers is incorporated in a written award and signed by them, it is binding upon the insurance company as well as the insured.

After the value of the loss has been agreed upon, the amount of the insurance company's liability is next determined. This is not necessarily the same as the actual loss. It is generally subject to a number of clauses in the policy, the application of which is frequently a complicated matter. One of these is the pro-rata or contributing clause, which in the standard policy reads as follows: "This Company shall not be liable under this policy for a greater proportion of any loss . . . than the amount hereby insured shall bear to the whole insurance, whether valid or not, or by solvent or insolvent insurers covering such property." Most frequently, 80% is inserted in the blank space and for that reason it is called the 80% coinsurance clause.

PROPER RECORD-KEEPING TO FACILITATE FIRE LOSS ADJUSTMENT

Necessity of Being Able to Prove Loss—Gross Profit Method of Inventory in Proving Loss of Stock-in-Trade

Need of Proper Records.—Most of the differences which cause delay in the making of adjustments for fire losses result from the inability of the insured to prove satisfactorily the amount of his loss. Failure to prove loss usually results from a slipshod manner of keeping records and a loss of the supporting vouchers. The standard policy provides that the insurance company may require presentation of original bills and vouchers to establish the cost of the property destroyed. Accordingly, to secure prompt adjustment of fire loss, the record of all assets should be supported by original vouchers. When the asset account is a group account, consisting of numerous pieces of property, a subsidiary ledger, register, or inventory record, as it is sometimes called, should be kept so as to evidence the various items of property and show their cost. For machinery, tools, furniture and fixtures, delivery equipment, etc., the use of such register is particularly advantageous. If the voucher system of account-keeping is in use, there will be supporting records for all charges to asset accounts and the cost of any destroyed property can be determined from these.

Loss of Stock-in-Trade.—When stock-in-trade is lost by fire and no perpetual or book inventory has been kept, it may be necessary to determine the value of the merchandise destroyed by means of the gross profit method of inventory (see page 176). For this the record of all purchases, purchase returns, sales, and sales returns up to the time of the fire and for previous years, should be available in order to determine the average rate of gross profit. If such rate of gross profit is not available, a rate must be agreed upon by the insured and the insurance company, as a basis of settlement.

Descriptions of Property in Policies.—To facilitate ready adjustment for fire losses, it is very essential that property insured can be identified from its description in the policy. This is true particularly if insurance is carried on different pieces of property with different companies. If the descriptions of buildings in policies are very indefinitely worded, disputes will arise as to whether the property destroyed is covered by the policy in question.

BOOK ENTRIES FOR FIRE LOSSES

Adjusting Book Value of Property Lost—Unexpired Insurance Lost—Cash Settlement for Fire Loss

Adjusting Entries for Fire Losses.—The method of making adjusting entries for fire losses is illustrated in the example given below. Immediately before the fire it is assumed that the accounts for the properties destroyed contained the following balances:

Building	$30,000.00	
Reserve for Depreciation—Building		$3,000.00
Store Fixtures and Furniture	$ 5,000.00	
Reserve for Depreciation—Store Fixtures and Furniture		$1,000.00

By the gross profit method of inventory (see page 176), it is found that $15,000 was the value of the merchandise stock which was destroyed by fire.

The books of the firm are closed at the end of each calendar year, and the fire occurred on June 30, or exactly a half-year after the preceding closing. The book value of the building is determined by subtracting from $30,000, the original cost of the building, the balance of $3,000 in the Depreciation Reserve account for the building; hence, the depreciated or net book value of the building when the books were closed in the preceding December 31 was $27,-

000) (see page 334). By similar procedure the depreciated or net book value of store fixtures and furniture was found to be $4,000 on the previous December 31, or the original cost of $5,000 less the balance of $1,000 in the Depreciation Reserve account for this asset.

In accordance with the usual method of keeping the fixed accounts of trading concerns, entries in these accounts were merely made at the time of closing the books. After a fire, however, it was necessary to record depreciation for the half-year that elapsed since the preceding closing date, in order to have the book values of these two accounts as of the date of the fire. If the yearly amount which had been allowed for the depreciation of the building was $1,000 and for store fixtures and furniture $500, the depreciation for the half-year prior to the fire was in each instance half the yearly amount, or $500 for the building, and $250 for store fixtures and furniture. The following entries are, therefore, made to record the depreciation that accrued for the half-year prior to the fire:

Depreciation Expense	$500.00	
Reserve for Depreciation—Building......		$500.00
To provide depreciation for 6 months from January 1 to June 30.		
Depreciation Expense	$250.00	
Reserve for Depreciation—Store Fixtures and Furniture		$250.00
To provide depreciation for 6 months to June 30.		

After these entries the two asset accounts and their related Depreciation Reserve accounts have the following balances:

Building	$30,000.00	
Less: Reserve for Depreciation.............		$26,500.00
Store Fixtures and Furniture.................	$ 5,000.00	
Less: Reserve for Depreciation.............		$ 3,750.00

Hence, the depreciated book value of the building at the time of the fire was $26,500 and of store fixtures and furniture $3,750.

Fire Loss Account.—An account entitled Fire Loss is now set up, to which are closed all three asset accounts and the two Depreciation Reserve accounts. The entries are as follows:

Fire Loss	$15,000.00	
Inventory		$15,000.00
To close the estimated inventory to Fire Loss account.		

Fire Loss	$26,500.00	
Reserve for Depreciation—Building	3,500.00	
Building		$30,000.00
To charge Fire Loss with the depreciated book value of building.		

Fire Loss	$3,750,00	
Reserve for Depreciation—Store Fixtures and Furniture	1,250.00	
Store Fixtures and Furniture		$5,000.00
To charge Fire Loss with the depreciated book value of store fixtures and furniture.		

In addition to the loss resulting from the destruction of the asset, the unexpired insurance which covered the property destroyed is also lost.

Assume for the sake of illustration, that in the Unexpired Insurance Expense account on January 1, the balance was $250. This insurance expired on December 31 of the same year. The insurance from January 1 to June 30, or $125, is a current operating expense and is recorded on the books on June 30 by this entry:

Insurance Expense	$125.00	
Unexpired Insurance		$125.00
To record expired insurance January 1 to June 30.		

The balance of $125 in the Unexpired Insurance account is lost because of the fire and is recorded by this entry:

Fire Loss	$125.00	
Unexpired Insurance		$125.00
To set up loss through fire.		

A check for $40,000 is received from the insurance company in settlement of the insured's claim on his policy on August 1. The entry is as follows:

Cash	$40,000.00	
Fire Loss		$40,000.00
Settlement with insurance company.		

As the total fire loss amounted to $45,375, the firm's net loss was $5,375, shown by the debit balance of the Fire Loss account. This account is now closed to Surplus account if the business is a corporation, or to Capital account if it is a single proprietorship or a partnership. Assuming the business is a corporation, the entry is as follows:

Surplus	$5,375.00	
Fire Loss		$5,375.00
To charge surplus with net loss of fire.		

When the foregoing entries are posted, the Fire Loss account appears as follows:

FIRE LOSS

19—						19—					
June	30	Inventory—estimate value		15,000	00	Aug.	1	Settlement		40,000	00
	30	Building—depreciated value		26,500	00			Net loss to Surplus		5,375	00
	30	Fixtures and furniture — depreciated value		3,750	00						
	30	Insurance loss		125	00						
				45,375	00					45,375	00

INSURANCE REGISTER

Various Types of Insurance—Detailed Record of Expired and Unexpired Insurance—Insurance Tickler

Kinds of Insurance Carried by a Business Establishment.—Practically every business of any size carries various lines of insurance for the protection against loss of its property and for claims or losses due to liabilities imposed upon it by law. The most important form of insurance protection is, of course, that against fire losses, but in addition a business concern may carry special forms of insurance, such as the following:

1. Workmen's compensation insurance—against employers' liability for compensation for injuries to, or death of, workmen in their employ, arising from their employment.
2. Automobile insurance—to cover liability for damage to property or injury to persons caused in the operation of automobiles or motor trucks, and damage to, or destruction by fire, or loss by theft of the automobiles or trucks.
3. Steam boiler or power plant insurance—against destruction of property or injury to persons from explosions.
4. Public liability insurance—against injury to or loss of life of others than employees, caused by the business operations.
5. Insurance carried on the lives of important executives, whose death would seriously affect the earning power of the business.

There are many other forms of insurance which business firms generally or special classes of concerns may carry, and the foregoing are given only by way of illustration. Moreover, the various types of insurance may be carried with different companies, and expire on different dates.

NO. RECORD OF INSURANCE POLICIES FOR THE YEAR ENDED December 31st 19--

POLICY NO.	NAME OF COMPANY	AGENT	PROPERTY INSURED	AMOUNT OF POLICY	RATE	AMOUNT OF PREMIUM	UNEXPIRED PREMIUM FORWARD	DATE OF POLICY	DATE OF EXPIRATION	CANCELLATION DATE	CANCELLATION AMOUNT	REMARKS
			AMOUNTS FORWARDED									
105268	Hartford Fire Ins. Co.	Rowlan & Co.	Machinery & Mdse.	42000	1.47		591.70	12/15/30	12/15/31			Charge
112081	" " " "	" "	" "	63000	1.47		916.45	12/28/30	12/28/31			80% to Acct. 95
28309	Lloyds - London	Rule & Son	" "	3000	1.47	24.10		1/20/31	1/20/32			12% to Acct. 82
1063139	" "	" "	" "	20000	1.47	294.00		2/14/31	2/14/32			8% to Acct. 78
1895	Metropolitan Ins. Co.	J. W. Kay & Co.	" "	18000	1.47	176.40		3/15/31	3/15/32			
123642	Hartford Fire Ins. Co.	Rowlan & Co.	" "	5000	1.47	73.50		4/21/31	4/21/32			
1895	Metropolitan Ins. Co.	J. W. Kay Co.	CANCELLED		1.47	132.30				6/16/21	120.00 –	
1083140	Lloyds - London	Rule & Son	Machinery & Mdse.	12000	1.47	176.40		6/15/21	6/15/32			
						612.10	1508.15					

DISTRIBUTION OF PREMIUMS NO.

	JAN.	FEB.	MAR.	APR.	MAY	JUN.	JUL.	AUG.	SEP.	OCT.	NOV.	DEC.	PREPAID 19--
	51.45	51.45	51.45	51.45	51.45	51.45	51.45	51.45	51.45	51.45	51.45	25.75	
	77.17	77.18	77.18	77.18	77.17	77.18	77.17	77.18	77.17	77.18	77.17	67.53	
	.67	2.01	2.00	2.01	2.01	2.01	2.01	2.01	2.00	2.01	2.01	2.01	1.34
		12.50	24.50	24.50	24.50	24.50	24.50	24.50	24.50	24.50	24.50	24.50	36.50
(Note: Circled			7.35	14.70	14.70	14.70	14.70	14.70	14.70	14.70	14.70	14.70	36.75
amounts on Can-				2.45	6.12	6.13	6.12	6.13	6.12	6.13	6.12	6.13	22.05
celled policy rep-						7.35	14.70	14.70	14.70	14.70	14.70	14.70	36.75
resent red ink entry)						7.35	14.70	14.70	14.70	14.70	14.70	14.70	80.85
	129.29	143.14	162.47	172.29	175.95	175.97	175.45	175.97	175.94	175.97	175.95	140.62	140.94

Insurance Register

Form of Insurance Register.—It is therefore good practice to maintain a special and systematic record of all the essential details of each form of insurance carried and each policy taken out. This record is known as the insurance register, one form of which is illustrated on the preceding page. One purpose of the register is to show in detail the amount of the prepaid premiums which has been used up with lapse of time and the amount which remains as a ledger asset upon the closing of the books, in the Unexpired Insurance account (see page 452). Columns are provided in the register for each month of the year, and the amount of premium which expires each month is entered in the appropriate column against the name of the policy on which the premium was paid. The total of each monthly column is the amount of premiums which is to be charged to insurance expense for the month. The insurance register constitutes a sort of subsidiary ledger supporting the Unexpired Insurance account on the general ledger.

Schedule of Expired and Unexpired Insurance.—Where no such detailed record of the amounts of expired premiums is kept, a special schedule or statement should be prepared from the policies upon the closing of the books, so as to show how the amounts of expired and unexpired insurance premiums were arrived at. This schedule serves as the basis for the entry for the cost of insurance during the period just closed. It should be filed away for further reference when necessary.

Insurance Tickler.—An insurance tickler, or some system of automatically bringing dates of expiration of policies to the attention of the person responsible for their renewal, should be devised. It is unsafe to depend upon the insurance agents to make the renewals in season so as to avoid loss of insurance protection because of the lapsing of policies.

SELLING AND GENERAL EXPENSES

Functional Organization of Business—Purchasing and Selling Expenses—General Administrative Expenses—Financial Income and Expense

Classification of Expenses.—The typical manufacturing business is divided into four functional departments, as follows: Manufacturing, Selling, General Administration, and Financial Administration. The average mercantile business is also divided into four functional departments, but these are: Purchasing, Selling, General Administration, and Financial Management. It will be seen that the purchasing function in the mercantile business corresponds to the manufacturing in an industrial concern. In other respects, the two forms of business are the same in organization.

To control properly the activities in a business, the expenses incurred in each of its departments are usually segregated into separate groups of accounts. Expenses are, therefore, classified as: Manufacturing Expenses or Purchasing Expenses, Selling Expenses, General Administrative Expenses, and Financial Management Expenses.

Purchasing Expenses.—The costs of buying are additions to the cost price of merchandise, or the cost of manufacturing goods. Merchandise or materials costs are not merely the invoice amounts paid vendors, but include such expenses of buying as freight-in, cartage, and similar items, which are necessary to place the merchandise in the factory or store and are part of the cost of merchandise or materials bought. In a small trading business, it may not be expedient to keep the expenses of buying separate from the general expenses of operating the business, because the same few persons may be engaged in both buying and selling activities. In a larger business, however, where the volume of buying requires the maintenance of a separate buying or purchasing department, the expenses of this department will be kept separate and be included as a part of the cost of merchandise or manufacturing materials. Such expenses will include the salaries of the head buyer and his assistants, of the stenographic and clerical help, the cost of maintaining a catalog and price lists, and similar activities.

Selling Expenses.—In small retail stores, where only a few persons are employed in addition to the owner, it is frequently impossible to classify selling expenses in much detail. In larger establishments, if an efficient management is in charge, information as to the various kinds of selling expenses and their grouping to show the type of activity to which they belong, must be secured. Under this group of Selling Expenses will be included detailed information as to salesmen's salaries, salesmen's traveling expenses, sales office expenses, delivery expenses, and advertising. Under Delivery Expense will be included salaries of delivery men, automobile and truck repairs, the costs of gasoline, oil, special messengers, and so on.

General Administrative Expenses.—In this group of expenses are included the expenses of managing the business as a whole. These are expenses that do not belong entirely to any of the other groups of activities, but which nevertheless embrace them all. In a large establishment, the president or general manager is constantly devoting his time, partly to the buying or production activities, partly to the supervision of the sales activities, and partly to a consideration of the problems of financing his business. It is not usually possible to divide the cost of his salary equitably over these various activities. It is, therefore, classed as a general administrative expense. Most of the expenses of his office, such as stenographic and bookkeeping expense, correspondence, filing, and so forth, are also classed as general administrative expenses. In this group will also be found such account titles as: Office Salaries, Office Expenses, Office Supplies, Postage, Telephone and Telegraph, Stationery and Printing, Rent, Building Repairs, Depreciation, Light and Heat, Taxes, Insurance, and other similar items.

Financial Management Expenses.—In connection with the management of the finances of a business, certain types of information are desirable. Account titles are therefore kept with such items as: Interest Cost, Sales Discount, Bad Debts, Collection Costs, Credit Expenses. Under Credit Expenses will be recorded the costs of securing information concerning the responsibility of customers, the cost of securing credit information such as the credit rating service, and the cost of services furnished by various credit men's associations.

Financial Management Income.—The financial manager usually also has some items of income. If, as a means of financing the business, he accepts notes from customers in payment of their open accounts, he may require interest-bearing notes and thus secure some income from them. If the business is seasonal, and larger sums of cash are on hand at some seasons of the year than are required for operating the business, he will invest these temporarily in income-producing securities. By having sufficient funds on hand, he will be able to take advantage of the purchase discounts offered him when buying merchandise. Accordingly, information as to financial management income will be furnished under the heads of Interest Income and Purchase Discount.

NON-OPERATING INCOME AND EXPENSE

Operating Expense in a Mercantile and a Manufacturing Business—Treatment of Non-Operating Income and Expense on Profit and Loss Statement

Operating Income and Expenses Defined.—Income derived from the main activity of a business is called operating income. The chief source of operating revenue is sales, but there are also miscellaneous sources, such as interest received on notes receivable, on temporary investment of excess cash funds, or discounts on purchases. All expenses of operating a mercantile business, including those of purchasing and selling goods, are referred to as operating expenses. These likewise include certain financial expenses, as interest on loans, sales discount, and loss on bad accounts. The reference to buying, selling, general, and financial expenses as operating expenses is chiefly confined to trading establishments. In manufacturing enterprises the terms "cost of operations" or "operating costs" are used, but these pertain not to selling expenses nor to the general office expenses, but to the cost of manufacturing. Because of the obvious danger of confusion, the term "operating expense" is generally avoided in referring to selling and general expenses of a manufacturing concern.

Non-Operating Income and Expense.—Income derived by a business from a source other than from the main activity in which it is engaged is called non-operating income, and the expenses incurred in securing such non-operating income are called non-operating expenses. It frequently happens that the profits from regular operations are invested in activities outside the regular business. A concern may purchase several pieces of real estate, not for use in the business but to be rented to others. Owning real estate as an investment is not the main activity of the ordinary business. The income from such real estate, accordingly, is not operating income. In the profit and loss statement, this should be grouped separately and called Non-Operating Income. Likewise, the expenses incurred in maintaining and repairing these buildings, also those for depreciation, insurance, taxes, and the like, should not be grouped with the operating expenses on profit and loss statement, but be shown as a separate group called Non-Operating Expenses.

Extraordinary theft or fire losses of cash or other assets, regularly employed in the operation of the business, are also considered as non-operating losses or expenses.

CHART OF ACCOUNTS

Account Classification Based on Internal Organization—Systems of Numbering or Lettering Accounts—Example of Chart of Accounts

General Principle for Preparation of a Chart of Accounts.—A chart of accounts is a list or schedule of accounts used in a business. These are grouped or classified in accordance with a plan suitable to the particular needs of the business. The classification should follow the lines of internal organization so that the accounts will show the results achieved by the various departments since each department is in charge of an individual who aims at the efficient operation of the department. No two individual enterprises, even though engaged in the same general line of business, will necessarily have identical charts of accounts. Their account classifications will vary primarily because of differences in their organization and methods of operation.

Numbering of Accounts.—Few companies of any size nowadays use bound ledgers, except in the case of the general ledger. Most subsidiary ledgers are now comprised of files of cards or loose sheets held together in binders. The accounts are grouped or classified, and each group is given a number or letter. The accounts within each group are in turn numbered serially, as well as being named, and are kept in this numerical order. The systems differ, but the general principle of numbering accounts is illustrated in the chart of accounts given below, which also sets forth the titles and groupings of the accounts of a typical business. A similar arrangement may be secured by using letters or a combination of letters and numbers. For example, Current Assets may be designated as A1; Cash in Bank A11, etc.

Chart of Accounts

1 Asset Accounts

- 11 Current Assets
  - 111 Cash in Bank
    - 1111 First National Bank
    - 1112 Second National Bank
    - 1113 Third National Bank
  - 112 Petty Cash Fund
  - 113 Notes Receivable
  - 114 Accounts Receivable
  - *114V Reserve for Doubtful Accounts
  - 115 Merchandise
    - 1151 Inventory Raw Materials
    - 1152 Inventory Goods in Process
    - 1153 Inventory Finished Parts
    - 1154 Inventory Finished Goods
    - 1155
    - 1156
  - 116 Temporary Investments
  - 117 Accrued Income
  - 118 Prepaid Expenses
- 12 Permanent Investments
  - 121 Bonds
  - 122 Preferred Stocks
  - 123 Common Stocks
  - 124 Leases
  - 125 Real Estate
- 13 Fixed Assets
  - 131 Land
    - 1311 Used and Useful in Operation
      - 13111 Details in Subsidiary Books
    - 1312 Held for Speculative or Investment Purposes
      - 13121 Details in Subsidiary Books
  - 132 Buildings
  - 132V Depreciation Reserve—Buildings
  - 133 Machinery
  - 133V Depreciation Reserve—Machinery

* The V suffix indicates a valuation reserve applicable to the like numbered account.

134 Tools
135 Patterns
135V Depreciation Reserve—Patterns
136 Furniture and Fixtures
136V Depreciation Reserve—Furniture and Fixtures
137 Etc.
138
139

14 Intangible Assets
141 Goodwill
142 Patents
143 Trade-Marks
144 Franchises

15 Other Assets
151 Organization Expense
152 Advertising Deferred
153 Bond Discounts

2 Liability Accounts

21 Current Liabilities
211 Notes Payable
2111 Notes Payable—Banks
2112 Notes Payable—Trade Creditors
212 Accounts Payable
213 Accrued Expenses
214 Deferred Income

22 Fixed Liabilities
221 Bonds Payable

23 Other Liabilities

3 Vested Proprietorship Accounts

31 Capital Stock
311 Preferred Stock—Cumulative
312 Preferred Stock—Non-Cumulative
313 Common Stock—Class A
314 Common Stock—Class B
315 Capital Stock Subscriptions

32 Surplus
321 Capital Surplus
3211 Premium on Stock
3222 Reappraisal Surplus

- 322 Appropriated Surplus
  - 3221 Reserve for Sinking Fund
  - 3222 Reserve for Contingencies
  - 3223 Reserve for Pension Fund
- 323 Unappropriated Surplus
  - 3231 Undivided Profits
  - 3232 Earned Surplus

4 SUMMARY AND CLEARING ACCOUNTS

- 41 Profit and Loss
- 42 Cost of Goods Sold
- 43 Manufacturing

5 INCOME ACCOUNTS

- 51 Sales
  - 511 Merchandise
    - 5112 By Departments, etc.
  - 512 Consignments
    - 5121 Details in Subsidiary Records
- 52 Financial Management Income
- 53 Other Income

6 EXPENSE ACCOUNTS

- 61 Manufacturing
  - 611 Wages
  - 612 Raw Materials
  - 613 Freight on Raw Materials
  - 614 Manufacturing Expenses
- 62 Selling Expenses
  - 621 Salaries
    - 6211 Details in Subsidiary Records
  - 622 Traveling Expenses
  - 623 Commissions
  - 624 Advertising
  - 625 General Selling
- 63 Administrative Expenses
- 64 General Expenses
- 65 Financial Management Expenses
- 66 Other Expense

PRINCIPAL GROUPINGS OF ACCOUNTS

Accounts Based on Balance Sheet and Profit and Loss Statement—Asset and Liability Accounts—Proprietary Accounts—Income and Expense Accounts

Fundamental Classification.—The principal groups of accounts correspond to the underlying divisions of the two main financial statements—the balance sheet and the income statement.

The balance sheet yields three main groups:

1. Asset accounts
2. Liability accounts
3. Proprietary accounts

There are also three groups of income statement accounts:

1. Revenue accounts
2. Cost and expense
3. "Income" accounts

Asset Accounts.—Asset accounts are classified into two main groups—Fixed and Current. The fixed group is in turn subdivided into two classes—Tangible and Intangible. The following is a general classification of the Fixed Tangible group. This group includes the accounts with all assets constituting the general equipment necessary to conduct business operations, such as:

1. Land
2. Buildings
3. Machinery
4. Furniture and Fixtures
5. Delivery Equipment
6. Tools
7. Patterns, Drawings, Electrotypes, etc.
8. Deferred Charges, written off over a period of years

The Fixed Intangible group of those of a non-physical nature, includes the following:

1. Goodwill
2. Patents
3. Trade-Marks and Trade Names
4. Copyrights
5. Formulas
6. Franchises

The Current Assets are those which in the ordinary course of business will be converted into cash within a short time, usually one year. The following accounts come into this group:

1. Cash
2. Receivables
3. Inventory
4. Temporary Investments
5. Accrued Income
6. Prepaid Expense

Prepaid expense, however, is sometimes not grouped with current assets.

Liability Accounts.—This group of accounts is divided into Fixed and Current Liabilities. The fixed class consists of long-term indebtedness, such as bonds, mortgages, and long-term notes. Current liabilities, defined as those with a maturity of less than a year, such as accounts and notes payable, accrued salaries, rent, and taxes, and deferred credits or prepaid income from the payment of rent, insurance premiums, etc., received in advance. Deferred credits or prepaid income is sometimes excluded from the group of current liabilities.

Proprietary Accounts.—In the single-proprietorship, two accounts usually take care of the proprietor's investment in the business—the Capital account to represent his initial or more or less permanent investment, and the Drawing account for recording drawings, income (or loss) balances, and other special adjustments. Two similar accounts are carried for each partner in the case of a partnership. The two main proprietary accounts in a corporation are Capital Stock and Surplus. The Capital Stock account may, however, be subdivided into several accounts, depending upon the number of classes of issued stock. There may also be a number of accounts representing surplus derived from different sources or surplus appropriated for specific purposes.

Income Accounts.—Revenue accounts refer to those recording the income for the principal activities of the business. In a manufacturing or mercantile concern these are the receipts from sales of the product or stock-in-trade. For an electric company it is the sale of electricity, and for a railroad it is the sale of transportation service. Cost and expense accounts record all factors of the costs and expenses incurred in producing the main revenues, or the goods or services sold. "Income" accounts represent miscellaneous income and outgo, which are not incidental to the principal operations of the business, such as interest or rent received or paid.

INDIVIDUAL PROPRIETOR'S CAPITAL AND DRAWING ACCOUNTS

Illustration of Entries Made in Capital and Drawing Accounts—Two Methods of Closing Drawing Account

Purposes Served by Capital and Drawing Accounts.—Two accounts are set up on the ledger of the individual proprietor of a business to record his total investment in the business—his Capital, and his Drawing or Personal account. If the proprietor's name is Thomas A. Smith, the titles of these accounts will be:

Thomas A. Smith, Capital
Thomas A. Smith, Drawings (or Personal)

The Capital account records the proprietor's investment in the business—his original investment when he started the business, and all subsequent additions to it or withdrawals from it. Entries in this account are usually made only at the end of the year when the books are closed. The Drawing or Personal account shows all current changes made in the proprietor's capital investment during the year, generally consisting of withdrawals of cash and goods from the business for the proprietor's personal use. At the end of the year after the balance of the Profit and Loss account is transferred to the Drawing account, the latter is closed into the Capital account. The balance then represents the proprietor's entire investment in the business—his original and subsequent contributions to the business, plus all profits and less withdrawals and any losses. The Capital and Drawing accounts constitute the net worth or net assets of the business, or the difference between the total assets and the total debts of the business.

Book Entries Illustrated.—The balance of the Capital account will normally be a credit balance. When Thomas A. Smith makes the original investment in his business, the entry made in the journal is as follows:

Cash	$5,000.00	
Thomas A. Smith, Capital..................		$5,000.00
Original investment in business.		

Any subsequent additions to this investment from his personal funds will receive like treatment.

The Drawing account during each year will be debited with all withdrawals of cash and merchandise from the business by the proprietor for personal use. The debit for merchandise withdrawals should be at cost and not at the selling price.

When Thomas A. Smith withdraws $600 cash from his business, he will make the following entry in his cash journal:

Thomas A. Smith, Drawings....................	$500.00	
Cash		$500.00
Thomas Smith withdrew cash for personal use.		

When goods are similarly withdrawn, the entry will be:

Thomas A. Smith, Drawings....................	$400.00	
Merchandise Inventory		$400.00
To record merchandise taken for personal use.		

The Drawing account will thus receive debit entries during the year. At the close of the year, after it has been credited with the balance of the Profit and Loss account, and it in turn is balanced and closed into the Capital account, it will appear as follows:

Thomas A. Smith, Drawings

19—						19—					
Feb.	7		CD2	500	00	Dec.	31	Profit for the year	J15	2,000	00
June	18		CD8	400	00						
Sept.	8		CD8	600	00						
Dec.	31	Capital a/c	J15	500	00						
				2,000	00					2,000	00

After the Drawing account has been closed into the Capital account, the latter may be balanced and ruled up to show the net worth, or the proprietor's investment in the business, as follows:

Thomas A. Smith, Capital

19—						19—					
Dec.	31	Net Worth—down		6,500	00	Jan.	15	Investment	J1	5,000	00
						July	21	Additional investment	J10	1,000	00
						Dec.	31	Drawing a/c	J15	500	00
				6,500	00					6,500	00
						19—					
						Jan.	1	Net Worth		6,500	00

An Alternative Procedure.—In the procedure followed in the foregoing illustration, the Profit and Loss account balance was transferred to the Drawing account by the entry:

Profit and Loss....................................	$2,000.00	
Thomas A. Smith, Drawings...............		$2,000.00
To close Profit and Loss into Drawings account.		

While this procedure is preferred by some, others follow the practice of closing Profit and Loss directly into the Capital account by the following entry:

Profit and Loss....................................	$2,000.00	
Thomas A. Smith, Capital..................		$2,000.00
To close Profit and Loss into Capital.		

The Drawing account will be closed into the Capital account as under the other method.

PARTNERSHIP CAPITAL AND DRAWING ACCOUNTS

Partnership Distinguished from a Corporation—Entries Made in Partners' Capital and Drawing Accounts—Closing of Drawing Accounts

Partnership Defined.—A partnership is defined as an association of two or more persons to carry on, as co-owners, a business for profit. A partnership, however, should be carefully distinguished from a corporation also formed by the association of a number of persons but as stockholders. The legal rights, powers, and liabilities of the members of a partnership are quite different from those of the stockholders of a corporation. For example, each individual partner is personally liable to the extent of his private wealth for the debts of the partnership. If the partnership cannot pay its debts, creditors may sue the partners individually to collect their claims. On the other hand, a stockholder, except in special cases, is free from liability for the debts of the corporation, and he can only lose his investment made when he purchased its stock, and nothing more.

A partnership is formed by a written contract known as the articles of co-partnership, which will govern the mutual relations in the conduct of the partnership business, and among other things will set forth the amount of capital to be contributed by each partner, the drawings or withdrawal of cash or goods to be allowed each, and the portion of the annual profits to be allotted to each partner. The basis for the apportionment of the profits among the several partners frequently involves rather complicated mathematical calculations.

General Nature of Entries Made in Capital and Drawing Accounts.—In recording his interest in the partnership, a Capital and a Drawing account are set up in the ledger for each partner. The method of accounting for each partner's investment, his share in the profits of the partnership as specified in the articles of partnership, and his withdrawals, are similar to the methods used on the books of the individual proprietor of a business. Instead, however, of a single Capital account and a single Drawing account, there is a Capital account and a Drawing account for each partner. If the name of one of the partners is Harry L. Miller, the titles of his Capital and Drawing accounts will be:

Harry L. Miller, Capital
Harry L. Miller, Drawings

The partner's investments are credited to their Capital accounts. The investments need not be in cash, but may consist of merchandise, buildings, delivery equipment, etc., contributed directly by a partner. Or one of the partners may contribute as his share of the total partnership investment a going business, and in that case the partnership not only takes over the assets of the business but also assumes its liabilities—the accounts payable, for example.

Entries Illustrated—Capital Contributions and Withdrawals.—Suppose Harry L. Miller forms a partnership with Howard Fox, and according to the articles of partnership, Miller contributes to the partnership capital $6,000 in cash, while Fox contributes a business which he has been conducting as an individual proprietor. The agreement, however, is that he shall turn over to the partnership all the assets of the business exclusive of cash, and it is further agreed that the partnership will assume responsibility for the debts of the business. The excess of the value of the assets over the amount of the liabilities will be Fox's capital contribution. To record Miller's capital contribution, the entry will be as follows:

Cash	$6,000.00	
Harry L. Miller, Capital....................		$6,000.00
Original investment in partnership.		

To record Fox's contribution, the entry will be as follows:

Accounts Receivable (given in detail)............	$2,000.00	
Merchandise Inventory	4,000.00	
Accounts Payable (given in detail).........		$1,000.00
Howard Fox, Capital......................		5,000.00
To record assets, except cash, and liabilities taken over from Fox.		

It will be noted that Fox's net capital contributions to the partnership is $5,000. The value at which the accounts receivable and merchandise are taken over by the partnership is mutually agreed upon between the two partners. This may be the book value at which Fox had carried them on his own books, or it may be more or less than that book value. Fox's capital contribution was determined by taking the total agreed upon value of the accounts receivable and merchandise and subtracting the accounts payable.

As additional investments are made in the partnership, these are credited to the respective Capital accounts. During the year, each partner will withdraw certain sums of money from the business for his personal use, as permitted by the articles of partnership. These withdrawals will be debited to his Drawing account, with corresponding credits to Cash, in the same manner as when an individual proprietor withdraws cash from his business (see page 384).

Closing of Drawing Accounts.—At the end of each year, when the books are closed, the Drawing account of each partner will be closed into his Capital account by the following entries:

Henry L. Miller, Capital	$1,800.00	
Henry L. Miller, Drawings		$1,800.00
To close Miller's drawing account.		
Howard Fox, Capital	$1,400.00	
Howard Fox, Drawings		$1,400.00
To close Fox's drawing account.		

Likewise, at the close of each year, the balance of the Profit and Loss account, representing net profit, will be divided between Miller and Fox in the proportions set forth in the partnership agreement. Their Capital accounts will be credited with their respective shares. If the total profits amount to $4,000 and are divided equally between the two partners, the entries will be:

Profit and Loss	$4,000.00	
Henry L. Miller, Capital		$2,000.00
Howard Fox, Capital		2,000.00
To close the Profit and Loss account and divide the profits equally as per partnership agreement.		

When all these entries have been made in the Capital accounts, these may be balanced and ruled. The new balance in each case is brought down immediately so as to show each partner's capital interest in the partnership at the beginning of the ensuing year. The Capital and Drawing accounts for each partner will then appear as set forth below:

Henry L. Miller, Capital

19—					19—					
Dec.	31	Drawings	J11	1,800 00	Jan.	1	Original investment	J1	6,000 00
		Net Worth – down		6,200 00			Net Profit		2,000 00
				8,000 00					8,000 00
					19—				
					Jan.	1		J15	6,200 00

Henry L. Miller, Drawings

19—					19—				
Feb.	19		CD6	600 00	Dec.	31	To Capital Account	J11	1,800 00
July	12		CD8	500 00					
Nov.	2		CD10	700 00					
				1,800 00					1,800 00

Howard Fox, Capital

19—					19—				
Dec.	31	Drawings	J11	1,400 00	Jan.	1	Original investment	J1	5,000 00
		Net Worth – down		5,600 00			Net Profit		2,000 00
				7,000 00					7,000 00
					19—				
					Jan.	1		J5	5,600 00

Howard Fox, Drawings

19—					19—				
Mar.	5		CD6	800 00	Dec.	31	To Capital Investment	J11	1,400 00
Aug.	13		CD8	300 00					
Dec.	5		CD11	300 00					
				1,400 00					1,400 00

NO-PAR VALUE STOCK

Laws Pertaining to Issuance of Stocks Without Par Value—Issue Price of No-Par Value Stocks—Division of Proceeds Between Capital Stock and Surplus

Authorization of No-Par Value Stocks.—To overcome certain disadvantages which stocks with par value have, nearly all states since 1912 have passed laws permitting corporations to issue stock without par value. The laws in most cases pertain to all classes of stock—common, preferred, and special. Certain corporations, however, are excluded from this privilege. These are usually banks and trust companies, savings banks, building and loan associations, and insurance companies.

Contrasted with Par-Value Stocks.—This type of shares differs from those having par value chiefly in two particulars:

1. The issue price, or the price at which no-par value shares may be sold, may be fixed by charter, or by the stockholders, or, as is usually the case, by the directors, in accordance with the provisions of the law of the particular state. Unlike par-value shares, there is generally no fixed minimum price applying to all issues of the same stock, at which they may be sold.

2. The proceeds received from the issue of no-par shares may be divided between the capital stock and surplus of the corporation as the charter, stockholders, or directors may determine. The general method of determination is usually prescribed by state law. The entire proceeds may be credited to surplus. There is no figure like that of par value attaching to each share of stock to determine how this apportionment should be made. There may, however, be legal restrictions on the power of allocating proceeds from no-par value issues, between Capital Stock and Surplus. This is par-

ticularly true in the case of proceeds from the sale of certain classes of stock, such as preferred stocks.

CAPITAL, CAPITAL STOCK, AND CAPITALIZATION

Purpose of Capital Stock Account—Issued and Unissued Capital Stock—Shares of Stock Defined—Rights and Liabilities of Stockholders

Capital and Capital Stock.—Capital stock is that portion of a corporation's net worth which may not be trenched upon by directors declaring dividends and which can be reduced, aside from losses due to operations, only by means of certain legal formalities prescribed by statute. The portion of the net worth from which dividends may be paid is surplus. Capital stock, in other words, is the margin of safety which the law prescribes primarily for the protection of the corporation's creditors, because of the fact that the stockholders are free from personal liability for the debts of the corporation. Capital stock is represented by the aggregate par value of the issued shares, or in the case of no-par value stock by an amount which may be determined more or less independently of the number of shares outstanding. It is frequently referred to merely as "capital" or "stated capital," the latter term being employed especially in connection with stock without par value. In balance sheets, however, it is general practice to use the term "capital stock."

Authorized and Issued Capital.—The authorized capital stock is the total amount of stock with par value or the total number of shares without par value which may be issued, as specified in the corporation's charter. The amount can be increased or decreased only by the stockholders taking the proper steps to amend the charter. Since frequently only a portion of the total authorized amount is issued, the corporation may have both issued and unissued stock. Issued stock consists of: (1) outstanding stock, and (2) stock reacquired by the corporation, but not retired, being kept alive, as it were, in the corporation's treasury.

Capitalization and Capital.—Capitalization is a term frequently employed in financial circles to indicate the total capital stock and the funded or bonded debt of a corporation. As used by some accounting writers, however, "capitalization" often refers only to the outstanding capital stock, especially at the outset of a new or newly reorganized enterprise. The term "authorized capitalization" is sometimes used with reference to authorized capital stock.

Shares of Stock.—The total stockholders' interest, capital stock and surplus, constituting the corporation's net worth, is divided into a certain number of equal fractions called shares. If there are several classes of stock issued, each class is divided into a number of equal shares. According to law, shares of stock are uniform, transferable contracts which the stockholders have with the corporation and with each other, conferring upon the holders certain rights and perhaps imposing upon them certain liabilities. The stock certificate is merely the paper evidence of the ownership of a certain number of shares.

Rights and Liabilities of Stockholder.—Unless otherwise provided by statute or charter provisions, the owner of capital stock possesses the three fundamental rights of participation in the profits, participation in its assets upon dissolution of the corporation, and a voice in the management or voting power. The extent of his participation in these three rights depends upon the proportion of the total issued shares he holds. In addition, stocks may be made subject to redemption at the option of the corporation or otherwise, and they may carry the privilege of converting into stocks of another class. Of the obligations imposed upon stockholders, the most common is the requirement that payment be made in full for the shares in accordance with the terms of the subscription agreement, including the full par value in the case of stock with par value. Special liabilities are sometimes imposed by statute, which modify the general rule of stockholders' exemption from liability for the debts of the corporation. Stocks may be issued in various classes depending upon the rights accorded. They may carry certain preferential rights to dividends or assets, in which case they are called preferred stock, and they may be subject to various restrictions, such as limitation or omission of voting power.

AUTHORIZED AND UNISSUED STOCK

Authorized Stock Defined—Recording Unissued Stock by Memorandum Entry—By Formal Entry in the Books of Account

Memorandum Entry of Authorized and Unissued Stock.—The authorized capital stock is the number of shares a corporation is allowed by its charter to issue. Any increase of that number can only be effected by taking the proper legal steps to amend its charter after the consent of the stockholders has been obtained. All the shares which a corporation may be authorized to issue may not be issued at once. A certain number may be reserved for issuance in the future. In the meantime it is desirable to keep a formal record of the amount of unissued stock. One method is to make memorandum entry of the total authorized amount and the amount still remaining unissued. This will be without any financial significance, and may take the following form:

Total par value of authorized stock........................	$150,000.00
Amount of stock issued....................................	100,000.00
Amount of stock unissued................................	$ 50,000.00

Method of Recording by Formal Entry in Books.— However, because the total amount of authorized stock and total amount remaining unissued are significant facts, which must not be overlooked, a formal record is frequently made in accounts that are a part of the entire double-entry system of accounts. Assume, for example, that a corporation is organized with a total authorized capital stock of 1,500 shares, each of a par value of $100, total par value of $150,000. It issues at par, however, only 1,000 shares, or a total par value amount of $100,000. The total authorized amount will be recorded by the following entry:

Unissued Stock	$150,000.00	
Capital Stock		$150,000.00
To record a total authorized stock of 1,500 shares of $100 par value each.		

When the stock is subscribed, but not immediately paid for, the entry is as follows:

Stock Subscriptions	$100,000.00	
Unissued Stock		$100,000.00
To record subscriptions to $100,000 of the authorized stock.		

After this entry is made, the Unissued Stock account will have a balance of $50,000, which is the amount of the stock remaining unissued. When the stock subscriptions are paid, the entry will be as follows:

Cash	$100,000.00	
Stock Subscriptions		$100,000.00
To record to collection of stock subscriptions.		

By the above entry the Stock Subscriptions account is balanced and closed, and only the Capital Stock account with a balance of $150,000, and the Unissued Stock account with a balance of $50,000, remain.

THE CAPITAL STOCK ACCOUNT

Recording Stock Subscriptions—Stock Issued at Premium or Discount—When Shares Are Issued Without Par Value—Changes in Balance of Capital Stock Account

Capital Stock Defined.—The total net worth of a corporation is the excess of the value of its assets over the total amount of its liabilities. This is divided into two major accounts, called Capital Stock and Surplus. The principal function of the Capital Stock account is to record the portion of the net worth which the board of directors is by law unauthorized to distribute as dividends to stockholders, primarily for the protection of the corporation's creditors. The amount set up in the Capital Stock account will consist of all or a major portion of the sums subscribed or contributed by stockholders upon the first issue and any subsequent issue of shares of stock. It may be added to later by transfers from the Surplus account. If there are several classes of stock outstanding, such as Common and Preferred, there is a Capital Stock account for each class.

The Surplus account carries the remainder of the net worth, and may consist of a portion paid in by stockholders and a portion representing accumulated profits. Dividends may be paid only from surplus—under the laws of some states from the paid-in portion when the earned part of the surplus is exhausted, and under the laws of other states only out of the earned portion. Accountants generally favor payment of dividends only out of earned surplus.

Stock Subscriptions and Payments.—When stock is subscribed for but before the subscriptions are actually paid, the corporation acquires an asset in the form of the stockholders' liability to pay it certain stipulated amounts. This asset called Stock Subscriptions is in the nature of accounts receivable, though always kept in a separate account. Assume, for example, that a corporation when first organized, issues 1,000 shares of common stock, each of a par value of $100, and that the subscription price or the amount paid for each share is also $100. The total amount subscribed will, therefore, be $100,000. The entry is as follows:

Stock Subscriptions	$100,000.00	
Capital Stock		$100,000.00
To record subscriptions to the capital stock as follows:		
A............................ – Shares		
B............................ – "		
C............................ – "		
etc.		

It is a rule of law that no portion of the amount paid in by stockholders equal to the aggregate par value of the issued shares may be distributed in dividends. Accordingly, the aggregate par value must be set up as Capital Stock, as shown in the above example. When all the stock subscriptions are paid for in cash, in the course of a few days, weeks, or months following, the entry will be as follows:

Cash	$100,000.00	
Stock Subscriptions		$100,000.00
To credit subscribers for the payment of their subscriptions.		

Stock Issued at a Premium.—Assume that in the above example the stock was issued for $105 a share, or at a premium of $5 above its par value of $100. The total stock subscriptions will then amount to $105,000, of which $100,000 represents the aggregate par value of the shares, and $5,000 the aggregate amount of premium paid for the shares. The entry will then be as follows:

Stock Subscriptions	$105,000.00	
Capital Stock		$100,000.00
Premium on Stock....................		5,000.00
To record subscriptions to the capital stocks, etc. (same explanation as in first entry above).		

The total premium received for the shares is carried in an account called "Premium on Stock." This premium represents the paid-in portion of the surplus of the corporation. It is not included in the Capital Stock account because legally in some states it may be paid back to the stockholders in the form of dividends, though it may not be wise to do so from a purely business point of view, and generally the corporation has no intention of doing so.

Stock Issued at a Discount.—Stock with par value is occasionally issued at a discount below par. If in the foregoing example the stock is offered for subscription at $90, so that only $90,000 is received for the total par value of $100,000 of the shares issued, the entry is as follows:

Stock Subscriptions	$90,000.00	
Discount on Stock...........................	10,000.00	
Capital Stock		$100,000.00
To record subscriptions to Capital Stock, etc. (same explanation as in first entry above).		

On the balance sheet the item of discount on stock is either included among the assets or is presented as a deduction from Capital Stock.

Capital Stock When Shares Are Without Par Value.—In the case of par-value stocks, the aggregate par value of the shares issued constitute the balance of the Capital Stock account. In the case of stocks without par value, the amount of Capital Stock account is determined in a different manner. The law prescribes the method or alternative methods. The amount of stock subscription proceeds to be allocated to Capital Stock may be determined by charter, or by vote of the stockholders, or by directors with or without special authority granted them by the stockholders. In most cases directors decide the division of the stock proceeds between Capital Stock and Surplus. This they may do by assigning a so-called stated value to each share of stock isssued which has some resemblance to par value, and crediting Capital Stock with the total stated value of all the shares. Or they may merely assign to Capital Stock a lump sum from the subscription proceeds. Of course, they may capitalize the entire proceeds if they so desire.

Suppose, for example, a corporation issues 1,000 no-par value shares at $45 per share, or for a total of $45,000. The directors, being legally empowered to do so, therefore vote to set up the entire amount as Capital Stock. The entry is the same as when par-value stock is issued at par, namely:

Stock Subscriptions	$45,000.00	
Capital Stock		$45,000.00
To record subscriptions to no-par capital stock, etc.		

Suppose, on the other hand, the directors decide to credit only $40 per share to Capital Stock, or a total of $40,000, while the balance of $5,000 is to be carried in a separate surplus account called Paid-in Surplus. The entry will, therefore, be as follows:

Stock Subscriptions	$45,000.00	
Capital Stock		$40,000.00
Paid-in Surplus		5,000.00
To record subscriptions to no-par capital stock, etc.		

Changes in Balance of Capital Stock Account.—The credit balance of the Capital Stock account, when the shares of stock have par value, varies only with the total par value of the issued shares. As the number of issued shares is increased or decreased, or as the par value itself is increased or reduced by amendment of the corporation's charter, the balance of that account will be changed. On the other hand, in the case of no-par value shares, the corporation may make transfers from Surplus to Capital Stock irrespective of the number of shares of stock outstanding. But it cannot make the transfer the other way and reduce the Capital Stock account without the consent of a certain majority of the stockholders prescribed by law.

Immediate Payment of Stock Subscriptions.—In the foregoing examples, it has been assumed that a certain period of time, amounting to a few weeks or months, elapsed between the time of subscription for stock and the subsequent payment of the subscriptions, and it was therefore desirable to record the subscribers' liability on their subscriptions in the meantime. If, however, subscriptions are paid immediately, the entry is:

Cash	$100,000.00	
Capital Stock		$100,000.00
To record stock subscriptions and payment thereof, as follows:		
A........................... – Shares		
B........................... – "		
C........................... – "		
etc.		

SUBSCRIPTIONS PAYABLE IN INSTALMENTS, AND SUBSCRIBERS LEDGER

Payment of Instalments—Entries to Record Illustrated—Stock Subscription Ledger Controlled by Stock Subscription Account

Stock Subscriptions Account and Subscribers Ledger.—Subscriptions to the capital stock of a corporation may not be paid immediately nor subsequently in one payment, but may be payable in a series of instalments maturing on fixed dates, or as called by the directors. In that event a Stock Subscriptions account will be opened and will be debited with the total of all subscriptions received; and credited with the total of each instalment when collected from the subscribers. An account will also be opened with each subscriber, which will be debited with the amount of his subscription and credited with the amounts of the instalments as paid by him. The successive instalments or calls are numbered or dated for purposes of identification, and the entry of their collection is made by their respective numbers or dates.

The individual subscription accounts constitute a subsidiary ledger, referred to as a stock subscribers ledger or stock subscription ledger, which is controlled by the Stock Subscriptions account in the general ledger. The sum of the balances of the accounts in the subscribers ledger, which is the total amount still due on the stock subscriptions, should equal the balance in the Stock Subscriptions controlling account.

Book Entries Illustrated.—The following example illustrates the entries made on the general ledger.

Assume that $50,000 of stock is subscribed for at $100 and is to be paid for one-half in cash and the remainder in two equal instalments at the end of successive three-month periods.

To record the total subscriptions, the entry is as follows:

Stock Subscriptions	$50,000.00	
Capital Stock		$50,000.00
To record stock subscriptions.		

For the one-half cash payment, the entry is as follows:

Cash	$25,000.00	
Stock Subscriptions....................		$25,000.00
To record immediate cash payment for stock subscriptions.		

At the end of the first three months, the record is:

Call No. 1..................................	$12,500.00	
Stock Subscriptions		$12,500.00
To record the first call issued for payment of subscriptions to capital stock.		
Cash	$12,500.00	
Call No. 1..........................		$12,500.00
To record payment of the first call on subscriptions to capital stock.		

Similar entries at the end of the second three months are:

Call No. 2	$12,500.00	
Stock Subscriptions		$12,500.00
To record second and last call issued for payment of subscriptions to capital stock.		
Cash	$12,500.00	
Call No. 2		$12,500.00
To record payment of second and last call on subscriptions to capital stock.		

If the call is not paid in full when the books are closed and the balance sheet is drawn up, the debit balance in the Stock Subscriptions account constitutes an asset, or the amount of unpaid instalments due from subscribers. Upon full payment of all subscriptions, certificates of stock are issued.

The foregoing represents one method of recording instalment subscriptions. Other methods are used, varying slightly from this general method.

THE SURPLUS ACCOUNT

Reason for the Surplus Account—Entries at Closing—Entries for Extraordinary Gains or Losses

Nature of Account and Entries at Closing of Books.— The Surplus account is the portion of a corporation's net worth which is not included in the Capital Stock account (see page 395). It represents the amount which may be distributed to the stockholders in the form of dividends, particularly if the surplus represents accumulated profits. The law varies in this respect between the several states. Unlike the Capital Stock account, which is affected only by such special transactions, as additional issues of stock or the retirement of a portion of outstanding shares, the Surplus account is credited regularly with the total determined profits or debited with the total determined losses of the corporation. At the end of the year, when the books are closed, the Profit and Loss balance, if it is a credit or profit balance, is transferred to the Surplus account, by the following entry:

Profit and Loss..............................	$15,000.00	
Surplus		$15,000.00
To transfer Profit for the year to Surplus.		

If the corporation sustained a loss for the year, shown by the debit balance of its Profit and Loss account, the entry for the transfer to Surplus account would be as follows:

Surplus	$5,000.00	
Profit and Loss.........................		$5,000.00
To transfer the loss for the year to Surplus.		

Entries for Extraordinary Gains or Losses.—Gains or losses due to special causes during the year, that is, those not resulting from the ordinary operations of the business, are entered directly in the Surplus account. Suppose, for example, as an inducement to build a plant in a particular city, a plot of ground is donated to the corporation by the city. Its net worth is increased by the value of that land. If the land is worth $10,000, the entry is:

Land	$10,000.00	
Surplus		$10,000.00
Donation of land by the City of .... to build plant located there.		

On the other hand, if the corporation sustains a heavy extraordinary loss, as when it is sued and compelled to pay heavy damages, the loss should be debited to Surplus.

DECLARATION OF DIVIDENDS

Payment of Dividends Determined by Directors—Entry When Dividend Is Declared—When Dividend Checks Are Mailed

Directors' Discretion in Declaring Dividends.—The primary purpose for which a corporation is organized is to make profits and distribute them in the form of dividends to its stockholders. However, such distributions of profits can only be made by the board of directors taking official action—declaring the dividend by a formal resolution. The law allows directors a broad discretion as to whether or not they should declare dividends on the outstanding shares of stock. Except in very unusual circumstances, directors may decide, as they see fit, whether to distribute a portion of the existing earnings in dividends to stockholders or to withhold such declaration of dividends and reinvest the profits in the business. In their decision they must be influenced not only by the presence of earnings as shown by the balance of the Surplus account, but also by the general cash position of the company, the volume of debts shortly to mature, the prospects for continued profitable operations, the opportunities for using available funds in improving and expanding the business, and other similar considerations which are for the ultimate benefit of the stockholders.

Entries When Dividend Declared and Paid.—Usually when a board of directors declares a dividend, it is provided in its resolution that the dividend shall be payable at some subsequent date. However, immediately upon the declaration, the total amount of the dividend becomes a debt of the corporation, the stockholders becoming its creditors to that extent. If the corporation has 1,000 shares outstanding and it declares a dividend of $3 a share, or a total of $3,000, the entry is as follows:

Surplus	$3,000.00	
Dividends Payable		$3,000.00
Dividend of $3 a share declared on stock July 15, 19–.		

Upon the appointed date when the checks are mailed to the stockholders, the following entry is made:

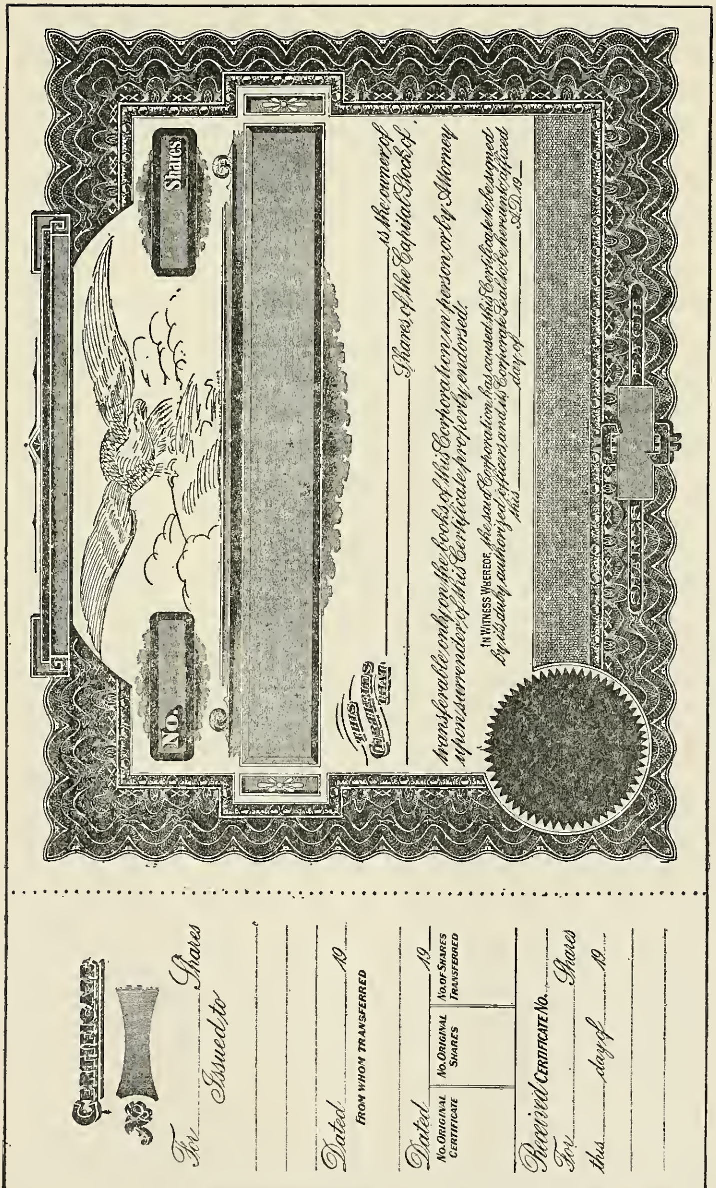
Dividends Payable	$3,000.00	
Cash		$3,000.00
Payment of dividend declared on stock July 15, 19–.		

THE STOCK CERTIFICATE

Stock Certificate as Distinguished from Shares of Stock—Form of Certificate When a Single Issue and When Several Issues are Outstanding

Stock Certificate as Evidencing Ownership of Shares.—The stock certificate is a printed or engraved document issued by corporations under their seal and the signatures, usually, of two officers, to stockholders to evidence their ownership of a number of shares of stock of a certain class. The certificate is not to be confused with the shares of stock themselves. The shares a stockholder owns comprise his interest in the corporation, while the stock certificate he holds is merely the paper representative or evidence of that ownership. Shares of stock may be owned without being evidenced by any certificate. Nevertheless, because of the convenience in making transfers of shares, or in pledging them for loans of money, and for other purposes, it is a universal custom for corporations to issue certificates to represent shares of stock, and by general law a stockholder is entitled to receive such a certificate from the corporation.

Form of the Certificate.—Where a corporation has a single issue of stock outstanding, the wording of the stock certificate is simple and brief. Besides being dated, and bearing a serial number, and indicating the authorized capital stock of a corporation, it will merely bear a statement certifying that the person named in the certificate is the owner of a certain number of shares of stock of the corporation, as shown in the accompanying certificate. Where several classes of stock are issued with varying rights as to voting power, dividends, payments upon the winding up of the corporation, and other rights and privileges, as in the case of the preferred stocks, a detailed statement of those


No. Shares

This Certifies That ____ is the owner of ____ Shares of the Capital Stock of ____

transferable only on the books of this Corporation in person or by Attorney upon surrender of this Certificate properly endorsed.

In Witness Whereof, the said Corporation has caused this Certificate to be signed by its duly authorized officers and its Corporate Seal to be hereunto affixed this ____ day of ____ A.D. 19__

Certificate No. ____

For ____ Shares

Issued to ____

Dated ____ 19__

From whom transferred

Dated ____ 19__

No. Original Certificate	No. Original Shares	No. of Shares Transferred

Received Certificate No. ____

For ____ Shares

this ____ day of ____ 19__

Stock Certificate and Stub

rights, privileges, and restrictions will be set forth on the preferred stock certificates and may be also on the common stock certificates.

STOCK CERTIFICATE BOOK

Preparation of Stock Certificate—Original Issue and Reissue of Stock—Surrender and Cancellation of Old Certificate

Preparation of Stock Certificates.—The stock certificate book is a bound book of blank stock certificates, together with the stubs to which they are attached. The certificates are detached from their stubs along a perforated line when issued. In preparing a stock certificate for issue, the blank spaces are filled in with the necessary details in both certificate and stub. These include the name of the stockholder, the number of shares he owns, the number of the certificate, and the date of issue. The certificate is fully executed when it is signed by two corporate officers, usually the president and the secretary, and is impressed with the seal of the corporation. The same details, other than the signatures of the officers and corporate seal, are also entered on the corresponding stub of the certificate as a convenient record of the issued stock certificate. On page 405 is illustrated a stock certificate and stub to be filled out preparatory to issuance of the certificate. If it is an original issue of stock, that fact is noted on the stub; if it is a reissue, the number of the old certificate surrendered is entered. The stub usually includes a receipt to be signed by the party to whom the certificate is issued. When thus filled out, the stub contains a complete record of its particular certificate from the time of its issue to the date of its surrender.

Issuance of New Certificate for One Surrendered.—When a new stock certificate is issued to one presenting the certificate for transfer, the individual who prepares the new certificate must be certain that the party surrendering the old certificate is entitled to a new certificate. In case of doubt, he should consult the company's attorney. A new certificate should never be made out or delivered until the old certificate has been surrendered in proper form. The surrendered certificate is canceled by cutting, punching, or crossing out the signatures, and by writing or stamping in bold letters across its face the word "Canceled." After such cancellations, the old certificate is reattached to the stub from which it was originally taken. The stock certificate book will, therefore, contain at all times the canceled stock and the unissued blanks. The government and state stock transfer tax stamps are usually pasted on the back of the stub describing the stock certificate so taxed.

STOCK LEDGER

Purpose and Form of Stock Ledger—Posting of Ledger—Stockholders' List and Balancing of Accounts in Ledger

Operation of Ledger.—The stock ledger is a subsidiary record controlled by the Capital Stock account and contains the accounts kept with the individual stockholders to record acquisition of shares by them and their transfer to other parties. The form of the account thus kept with each stockholder is shown below. When one becomes a stockholder, an account is opened in his name and is credited with the number of shares he has acquired. When he transfers shares to some other party, the account is debited. Columns are provided in the account to show dates of transfers, from whom and to whom transfers are made, the number of shares transferred, and the serial numbers of the stock certificates issued to the party in whose name the account has been opened.

Stockholders' List.—Just before the payment of a dividend or the holding of a stockholders' meeting, these stock-

. ... COMMON . . STOCK LEDGER

NAME W. T SMITH

ADDRESS 3413 SOUTH MICHIGAN AVENUE, CHICAGO, ILL.

Date			Original—Transferred From or To	Certificate No.		Record of Shares			Number of Certificate Issued Therefor
Month	Day	Year		Issued	Surrendered	Issued	Surrendered	Balance Outstanding	
3	1	27	Original Issue.	12		10		10	
4	3	27	Original Issue	31		5		15	
6	17	27	J. T. Thomas	69		30		45	
9	9	27	William C. Hazlitt	101		15		60	
12	10	27	Cecilia Maryott		12		10	50	135
12	14	27	Cecilia Maryott		69		10	40	135
12	14	27	Self	136	69	20	20	40	136

Form of Stock Ledger

holders' accounts are balanced to show the number of shares remaining to the credit of each stockholder, on which he is entitled to receive dividends or on account of which he is entitled to receive notice of a forthcoming stockholders' meeting. The secretary of the corporation or an assistant draws up a list of stockholders with the number of shares owned by each, and this list is used in making out dividend checks or in determining who are entitled to participate and vote in the stockholders' meeting.

The accounts in the stock ledger are usually posted directly from the stubs of the stock certificate book.

STOCK TRANSFER BOOK

Method of Transferring Stock—Registry on Transfer Book—Legal Owner of Transferred Shares—Transfer Procedure

Making Out Assignment Form.—Stock certificates are transferable by having the owner complete a form of assignment printed on the back of the certificates. Such form of assignment is shown below. It contains blank spaces for inserting the name of the party to whom shares are transferred, the number of shares transferred, which need not be the total number represented by the certificate, the date of the transfer, the signature of the owner, and the signature of a witness. The assignment form also provides space for the name of the person appointed as attorney to make the transfer. He will thereby be legally authorized to effect the transfer on the books of the corporation as representative of the present owner of the certificate.

When the assignment form is made out and signed by the owner of the certificate and is delivered to the one to

For Value Received, ____ hereby sell, assign and transfer unto ____
____ *Shares of the Capital Stock represented by the within Certificate, and do hereby irrevocably constitute and appoint* ____________________________________ *Attorney to transfer the said Stock on the books of the within named Corporation with full power of substitution in the premises.*

Dated ____________________ *19* ____

In presence of

____________________________ ____________________________

NOTICE. THE SIGNATURE OF THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UPON THE FACE OF THE CERTIFICATE, IN EVERY PARTICULAR, WITHOUT ALTERATION OR ENLARGEMENT, OR ANY CHANGE WHATEVER.

Stock Certificate Assignment Form

whom the shares are being transferred, the latter becomes the legal owner of the shares of stock represented by the certificate. However, in order to be entitled to the receipt of dividends when declared and paid by the corporation and of notices of stockholders' meetings, the transfer must be registered in the stock transfer book of the corporation, a form of which is shown on the following page. The registry consists of inserting the date of transfer, the number of the old certificate being surrendered, the number of shares represented by it, the signature of the one making the transfer or his attorney appointed in the assignment form on the back of the certificate, the number of the new certificate issued, and the number of shares represented by the new certificate. When the registry of the transfer of the shares

STOCK TRANSFER RECORD						
Date of Transfer on Books		Surrendered		Names of Stockholders involved in the transfer and signatures of Attorneys making the transfers	Re-issued	
		Cert. Nos.	No. of Shares		Cert. Nos.	No. of Shares
.....	.	......	......	By..........................	......	......
.....	.	......	......	To..........................	......	......
.....	.	......	......	....	......	......
.....	..	......	......	Signed.......................... (Attorney)	......	......
.....	..	......	......	By..........................	......	......
.....	..	......	......	To..........................	......	......
.....	..	......	......	....	......	......
.....	..	......	......	Signed.......................... (Attorney)	......	......
.....		......	......	By..........................	......	......
.....	..	......	......	To..........................	......	......

Stock Transfer Book

is thus effected, the new owner becomes entitled to a stock certificate made out in his name.

Transfer Procedure in Large Companies.—In large companies, whose stocks are traded in on stock exchanges and are therefore subject to frequent transfers, the procedure in transferring shares is as follows: The owner of a stock certificate who is making the transfer merely signs the assignment form on the back of the certificate in blank and delivers it to the buyer of the shares. When thus assigned in blank, the stock certificate is transferable by mere delivery, and it can thenceforth change hands any number of times without any further writing on the certificate, precisely as though it were a dollar bill. When one in lawful possession of the certificate desires to have it transferred on the books of the corporation, he sends the stock certificate to the corporation or its transfer agent, having first filled out the assignment form, except the space for the attorney who is to sign the transfer book. The one in charge of the corporation stock transfer book inserts his own name as attorney to make the transfer. Being thus authorized to sign the transfer book as the lawful attorney of the one in whose name the stock certificate stands, he proceeds to do so, and thereupon prepares and delivers a new certificate to the new owner of the shares of stock.

THE MINUTE BOOK

Same Book or Separate Books for Stockholders' and Directors' Minutes—Bound and Loose-Leaf Minute Books—Arrangement of Content

Its Purpose.—The minutes of corporate meetings are the records of their proceedings or transactions, put in writing by the corporation secretary or other recording officer. The minutes of stockholders' and of directors' meetings are kept in substantially the same form. In a small corporation there is usually only one minute book for recording the business conducted at both kinds of meetings, but in larger companies there are two minute books—one for directors' meetings and one for stockholders' meetings. Separate books may also be kept for the minutes of standing committees of directors. The minute book does not contain any debit or credit entries, but only a record of the transactions of stockholders' or directors' meetings in narrative form.

Form and Arrangement.—Some corporations record their minutes in a bound blank book or journal, the entries being made in longhand. While this method is cumbersome, it has the advantage that the record cannot be changed by substitution of pages. The loose-leaf binder, because of its greater convenience, is now more widely used, as the minutes can be typewritten and the sheets then slipped into their places in the binder. The objection to the loose-leaf book is the ease with which pages may be substituted, added, or subtracted. One way of meeting this objection is to have each page numbered and signed by the secretary, making substitution without the participation of this officer impossible.

In the most common arrangement of the minute book, a copy of the certificate of incorporation is entered first. Then come the by-laws, followed by a few pages left blank for future amendments. Next in order are the minutes of the first meeting of incorporators or stockholders. If the directors' minutes are kept in the same book, the first meeting of directors follows the first meeting of incorporators or stockholders. After that the minutes of subsequent meetings follow in chronological order.

BONDS ISSUED BY CORPORATIONS

Trustee under Bond Indenture—Denominations in Which Bonds Are Issued—Various Types of Bonds

Trust Deed.—Bonds are formal obligations of corporations, running for five years or longer, and are represented by a certificate impressed with the corporate seal. Essentially, these are simply long-term indebtedness which corporations incur in borrowing from investors. Bonds that are offered to the public are generally issued under a contract, known variously as mortgage, trust indenture, trust deed, deed of trust, etc., between the corporation and a trustee, usually a trust company. The trustee represents the bondholders in their collective capacity. The agreement with the corporation is a document usually of considerable length, defining the exact rights of the bondholders, their security, etc., the duties of the trustee, and, on the other hand, the covenants or obligations which the corporation has undertaken to perform in connection with the bond issue.

Classes of Corporate Bonds.—Corporations issue bonds with almost infinite variation in the terms. They are commonly classified into certain more or less standard groups as follows:

Coupon and Registered Bonds.—With respect to form, bonds are either coupon or registered bonds. The former owe their name to the fact that coupons are attached to them which represent claims for interest on the successive dates indicated. The collection of interest on the due dates is effected by detaching the coupons and cashing them. Coupon bonds are negotiable to bearer, passing by delivery, no record of the owner being kept by the corporation. The great bulk of coupon bonds are issued in denominations of $1,000, and less often $500 and $100. The names of the owners of registered bonds, however, appear on the books of the company as well as on the face of the bond certificate. Interest on them is payable, by check, mailed to the registered owner. The denominations of fully registered bonds are usually $1,000, $5,000, and $10,000. Coupon bonds may be registered as to principal to prevent loss by theft.

Mortgage Bonds.—These are secured by a mortgage on certain property specified in the indenture. If the total amount which the corporation is authorized to issue under the indenture is exhausted, the bonds are known as a closed issue. If no definite limit is set, they are called an "open-end" issue. If a maximum amount is fixed but it is considerably in excess of present requirements of the corporation, the bonds are referred to as a limited open-end issue.

Collateral Trust Bonds.—These are bonds secured by the pledge of securities of other companies. The bonds of certain public utility holding companies and investment companies are typical of this group. The pledge of securities, however, may and is frequently combined in the issues of railroad and public utility companies with a mortgage on real property.

Debentures.—Unsecured bonds are generally called debenture bonds. They are based simply on the general corporate credit without enjoying any special security. They may, however, be protected by a covenant in the indenture entitling them to equal security in the event a subsequent issue of bonds is put out which is secured by a mortgage.

Income Bonds.—Income bonds are issues which are entitled to interest only when earned. Their origin is commonly in reorganizations of failed concerns. The principal, however, may be secured by a mortgage or pledge of securities, or may simply be unsecured.

Convertible Bonds.—These bonds are convertible, at the option of the holders, usually into common stock. The terms of conversion are specified in the indenture, which relate chiefly to the time and rate of conversion. The purpose of their issue is to combine with the security of a bond the speculative opportunity possessed by a stock.

Guaranteed Bonds.—These are bonds guaranteed by another corporation, usually the parent company owning the stock of the issuing company, or by a railroad which has leased the property of the issuing company for a long term. The guaranty is either by an indorsement on the bond, by special agreement, by lease or operating agreement.

Redeemable or Callable Bonds.—These are bonds which the corporation may pay off at its option before the set date of maturity. Usually such redemption is effected at a premium above par to compensate the bondholder for the unexpected termination of his investment.

Refunding Issues.—These are bonds which have been put out to meet maturing issues. Ordinarily they are sold for cash which is applied to the payment of the maturing bonds. At times, however, holders of the maturing bonds receive an offer from the corporation to exchange the new bonds for the old.

Sinking Fund Bonds.—This class of bonds provides for the accumulation of a fund, usually by annual or semi-annual payments, to meet the payment on the due date of the bonds. In modern issues, however, the sinking fund is combined with the callable feature of the bond, and as soon as the periodical payment is made into the sinking fund, a number of bonds selected by lot are called and redeemed from the fund. These may be purchased in the market if the price at which they are selling is less than the price at which they may be called or redeemed.

PREFERRED STOCKS

Class of Stock as Determined by Charter or By-Laws—Special Rights and Restrictions of Various Classes—General Classification of Special Stock Issues

General Nature of Preferred Stocks.—Corporations are usually empowered to issue various classes of stock, besides the common, each differing from the others in the special rights it possesses, or the limitations and restrictions of certain stockholder rights it is subject to. It is simply a matter of contract between the corporation and the holders of the respective issues, as set forth in the charter, by-laws, or stock certificates. Summed up, these provisions consist of certain preferential rights as regards dividend payments and payments made when the corporation goes into liquidation, limitations upon the voting power, the special privilege or option of the stockholders to convert the stock into another class of stock and the corporation's right to redeem the stock at its election, or its duty to redeem a certain amount of the stock periodically.

Cumulative and Non-Cumulative Preferred Stocks.—Preferred stock gets its name from its prior claim to dividends, or to dividends and assets in liquidation. The prior claim to dividends may be cumulative or non-cumulative. Cumulative preferred stock is one entitled to receive dividends at the stipulated rate per annum before any dividends are paid to the common stockholders. If not paid in any year, the amount so in arrears must be paid as well as the current dividend before any distributions can be made on the common. Non-cumulative preferred stock is that which is entitled to receive the stated rate of dividends only in the years in which the directors in their discretion choose to declare them. Dividends unpaid in any year become a total loss to the preferred stockholders. In other words, unpaid dividends do not accumulate as a charge upon the company's earnings.

Second, Third, etc., Preferred Stock.—When a company has two or more issues of preferred stock outstanding, the preferential rights, privileges, qualifications, and restrictions of each are defined in the charter or certificate of incorporation. It is then customary to call the issues by number—first preferred, second preferred, and third preferred, for example. The first preferred has the first claim upon the earnings and assets up to stated amounts, the second has the next claim, while the third preferred ranks after it, the common shares coming last. Preferred shares may also be designated by letters, as preferred A, preferred B, etc., or may be called prior preferred, preferred, and junior preferred stock.

Participating and Non-Participating Preferred Stock.—Preferred stocks may be participating or non-participating either as to dividends, or as to assets, or as to both dividends and assets. If the dividends they are entitled to are limited to a fixed preferential rate, as 7%, and all subsequent earnings inure to the common stock, the preferred stock is non-participating as to dividends. If, however, it is given the right to share in the distribution of earnings in excess of the fixed preferential rate, it is participating as to dividends. Thus a preferred stock may have preference to dividends up to 7%, and participate with the common stock in all subsequent dividends share and share alike. Similar provisions may exist for the participation or non-participation in the assets upon liquidation after the preferred stock has been paid the fixed preferential amount.

Redeemable Preferred Stock.—Preferred stock may be subject to redemption or retirement. The redemption may be voluntary or at the option of the issuing company, or it may be compulsory, a certain amount to be redeemed each year or so, and for this purpose the company may be required to contribute periodically from its earnings a certain amount to a sinking fund. Usually a premium is paid for the stock redeemed, varying in amount up to 25% of its par value and higher.

Convertible Preferred Stock.—Convertible stock is a preferred issue which is exchangeable usually for a junior preferred or common stock at the option of the holder. The convertible feature is attached to preferred stock to render it more attractive to security buyers. The holder of such shares possess certain preferential rights and other protective features; and through the conversion privilege, particularly if it applies to common stock, he is in a position to share in any prosperity which may come to the company.

PAR VALUE OF STOCK

Par Value as Minimum Subscription Price—As Amount of Subscription Proceeds Credited to Capital Stock—Different Par Values

Nature of Par Value.—Stocks may be classified according to whether the shares have or have not a par or so-called nominal or face value. The par value is a more or less arbitrary figure set by the corporation charter and stated on the stock certificates. The significance of par value is that:

1. It fixes the minimum subscription price at which the shares must be issued, with certain exceptions permitted by law. An original sale of stock at a price below par value renders the purchaser liable for the deficiency to the creditors of the corporation should it become insolvent.
2. It determines the amount of the subscription proceeds which is to be credited to the capital stock. This is the aggregate par value of the shares. Premiums received for the shares in excess of their par value constitute paid-in surplus, frequently called Stock Premium account.

Stocks with Different Par Values.—Stock with par value of $100 per share was the rule at one time, and still is among railroads. Among many industrial and public utility companies, however, the par value has been fixed at much less than $100—at figures ranging usually anywhere from $1 to $25 or so. A few state laws prescribe the maximum and minimum par values which corporations organized under them may have, while other state statutes set no such limits.

BOOK VALUE OF A SHARE OF STOCK

How Book Value Is Computed—Computation as Affected by Cumulative and Non-Cumulative Preferred Stock

Meaning of Book Value.—Book value of a share of stock is the portion of net worth assignable to one share of a given class of stock. The procedure in figuring it, if there is only one issue outstanding, is to add together the capital stock and surplus and divide this sum by the number of shares issued. If a concern has a capital stock of $100,000, represented by shares with or without par value, and a surplus of $50,000, while the number of shares is 1,000, the book value of each share is $150,000 divided by 1,000 shares, or $150.

Book Value of Preferred Stock.—In the case of non-cumulative preferred stock, the book value is the par value, the stated value in the event the shares are without par value and have been given a stated value, or paid-in value when no-par shares have been given no stated value. When, however, there are dividends in arrears on cumulative preferred stock, the amount due on each share should be added to the par, stated, or paid-in value to determine the book value per share.

The presence of preferred stock makes necessary the subtraction of the total book value of the outstanding preferred shares from total net worth; dividing the remainder by the number of outstanding common shares yields the book value of a common share.

PREPARING THE MONTHLY TRIAL BALANCE

Purpose of the Trial Balance—What It Proves—Detailed Explanation of Two Methods of Taking the Trial Balance

Purpose of the Trial Balance.—The trial balance is simply the general ledger highly condensed or summarized. In its preparation the accounts contained in the ledger are listed. Against each the balance of the account is written, in the first column if a debit balance, and in the second column if a credit balance. Sometimes, instead of merely giving the balance of each account, the total of its debits and the total of its credits may be shown in the respective columns.

The preparation of the trial balance is commonly referred to as "taking the trial balance." Its purpose is to prove the accuracy of the general ledger after it is completely posted. If the posting work has been accurately performed, the ledger must be in balance. That is to say, the total debits of all accounts must equal the total credits. This follows from the fundamental principle on which double-entry bookkeeping is based, that for every debit there must be a credit of equal amount. While the ledger could be proved directly by arranging the accounts under each other and adding together all their debit items in one total and all their credit items in another total, this method would prove to be very burdensome and time-consuming. By means of the trial balance the work of proving is greatly simplified by dividing it into two steps. The first consists of ascertaining the balance of each account, or the debit total and credit total of each account. The second step consists of listing these balances, or the debit and credit totals, in two columns, and then footing the columns. The totals of the columns should be equal. If they are not, an error has been made in taking the trial balance, or in posting to the ledger, or in making the entries in the journals. An investigation is then necessary in order to locate and correct the error or errors.

The trial balance is taken at the close of each month, after all journals have been totaled and posted. Not until this posting is completed can the ledger be in balance. It should be noted that a trial balance is only taken of the general ledger. Because of the nature of most subsidiary ledgers, they cannot be in balance.

Two Methods of Preparation.—In the preparation of the trial balance, all ledger accounts are listed on a sheet ruled similar to the form below, which shows both methods of taking a trial balance. In the parallel money columns opposite the title of each account is placed either:

1. The total of the debits in each account in the debit column, and the total of the credits in the credit column (Method 1); or
2. The difference between the total debits and the total credits of each account in the appropriate column (Method 2). If the debits exceed the credits, there is a "debit balance" which is placed in the debit column. If the credits exceed the debits, the "credit balance" is placed in the credit column.

Method 1 has one distinct advantage, namely, that it shows the sum of all debits and all credits posted during the period. Hence, it follows that the total of the debit column in the trial balance must agree with the footings of

A. Brown
Trial Balance—January 15, 19–

		Method 1		Method 2	
Acct. No.	Accounts	Debits	Credits	Dr. Balance	Cr. Balance
1	Cash in Bank	$10,450	$6,815	$3,635	
	B. Peterson & Co	1,000	1,470		$470
	D. C. Tapp	400		400	
21	Land	2,500		2,500	
22	Furniture and Fixtures	500		500	
23	Auto Truck	750		750	
51	A. Brown, Capital		10,000		10,000
71	Sales		850		850
76	Purchases	3,345		3,345	
80	Store and Office Salaries	95		95	
81	Rent	50		50	
82	Delivery Expenses	45		45	
		$19,135	$19,135	$11,320	$11,320

Trial Balance

the debit columns of the books of original entry. The same applies to the credit side.

Method 2 is the one commonly used by accountants. It excludes all accounts which do not have open balances, thereby reducing the size of the trial balance.

Steps to be Taken in Preparing Trial Balance.—The procedure in preparing the trial balance is as follows:

1. Ascertain the total of the debit side of each ledger account; also the total of the credit side.
2. Insert these totals in small pencil figures beneath the last posting on each side. These figures should be small enough not to interfere with the posting to be made on the next line below. (See balanced account form below.)
3. Determine the balance of each account by subtracting the total of the lesser side from the total of the larger side and insert it in the explanation column as shown in the form. Debit balances are inserted on the left side and credit balances on the right side.
4. Under Method 2 list the debit balances in the debit (left-hand) column of the trial balance and the credit balances in the credit (right-hand) column. Under Method 1 the footings instead of the balances are listed.
5. Add the two columns of the trial balance. If the debit and credit totals are equal, the ledger from which the trial balance is drawn is said to be "in balance." The sum of the debits in all accounts in the ledger should equal the sum of the credits in all accounts. The same is true of the net balances in all accounts when they are listed in the trial balance according to Method 2. In such case the totals of the amounts omitted on the debit and credit sides, respectively, are equal, thus leaving the totals of the amounts inserted in the trial balance equal.

The pencil memo footings and balances placed in the accounts in steps 2 and 3 above constitute part of the ledger record and are not to be erased. By providing a starting point, the pencil footings reduce the amount of adding necessary in taking off the next trial balance. The pencil balances facilitate duplicating the trial balance in case it is lost. Furthermore, they can be used in the next trial balance if no additional debits or credits have been entered.

CASH IN BANK — Account No. 1

Date 19–		Explanation	F	Amount		Date 19–		Explanation	F	Amount	
Sept.	1		J1	5,000	00	Sept.	4		J2	200	00
	9		J2	400	00		11		J4	1,800	00
	17	6,800.00	J7	600	00					2,000	00
	20	2,000.00	J9	800	00						
		4,800.00		6,800	00						

Balanced Account in Ledger

Permanent Record of Trial Balances.—Suitable provision should be made for keeping a permanent record of the successive monthly trial balances after they prove, even though they are consulted infrequently. Because they are infrequently consulted, it is customary to enter them in a specially ruled bound volume, marked on the cover as the "Trial Balance Volume," or "Trial Balance Record," which may be purchased from stationers.

LOCATING ERRORS IN THE TRIAL BALANCE

What Trial Balance Does Not Prove—More Common Errors in Posting—How to Find Errors—Abstracting Journals

Trial Balance as a Proof of Accuracy.—The standard method used in checking the accuracy of the general ledger accounts is by taking a periodical trial balance of the ledger, generally monthly. If the trial balance is in equilibrium, that is, if the total debits equal the total credits, it tends to indicate that the bookkeeping was performed properly, but such equilibrium is not an absolute proof of accuracy. It does not prove the following, for example:

1. That the debits and credits are in the correct accounts. Thus, a posting made to the Building account instead of the Truck account would not disturb the equilibrium of the trial balance.
2. That the correct amounts were used in recording the transactions. Thus, a trial balance would not disclose that a sale of $50 had been recorded as $5.
3. That all transactions were recorded. The trial balance does not reveal failure to record a sale or a purchase or any other transaction because in such cases equal debits and credits are omitted.
4. That offsetting errors have not been made. Thus, if a debit of $80 were posted as $8 ($72 debit short) and a credit of $91 as $19 ($72 credit short), the trial balance would be in balance because the two errors offset each other.

Errors in Posting.—The more common errors which occur in posting are:

(a) Posting to the wrong account.
(b) Transposition of figures in posting.
(c) Posting wrong amount.
(d) Posting to the wrong side of the account.
(e) Posting the same item twice.
(f) Not posting the item at all.

Unless offsetting errors exist, all but the first are disclosed by a trial balance. The first is not disclosed by a trial balance and whether or not it is ever uncovered depends on (1) the nature of the accounts involved and (2) the thoroughness with which postings are rechecked. An amount posted to the wrong account receivable will usually be discovered by the customers when they examine their statements. An amount posted to the wrong nominal account will probably never be disclosed unless the postings are completely rechecked.

Procedure in Locating Errors.—If the totals of the debit and credit columns of the trial balance differ, it is necessary to search for errors. The following procedure is recommended. Take each step in the order indicated until the errors are found:

1. Determine the amount of the difference—it is useless to look for a difference unless its amount is known.

2. Refoot the trial balance—difference in a single figure or in two adjacent figures of the trial balance totals are often due to errors in footing.

3. Compare the ledger balances once more with the trial balance and at the same time recheck the ledger column totals since the last trial balance and subtract again to secure the present balance. Note any obscurity in the figures used in determining the preceding trial balance.

When footing either the trial balance or the ledger accounts, it is well to remember that the same error in footing may be made twice. Hence, in re-adding, it is desirable that the bookkeeper foot in a different manner—that is, add from the bottom up rather than from the top down; or use an adding machine if the number of postings warrants; or have some one else refoot the ledger, and so on.

4. See that the totals of books of original entry properly crossfoot and that these totals are all properly included in the trial balance accounts.

5. If the difference represents an apparent excess of debits over credits some item may have been entered twice among the debits in the books of original entry. The latter should be examined for such a sum.

6. If the difference is divisible by two and represents an apparent excess of debits over credits, one-half of the amount may be looked for among credits in books of original

entry, since such a credit, if posted as a debit, would cause a discrepancy of this nature.

7. A transposition is a reversal of two adjoining figures of an amount; \$86 posted as \$68 is an example. Transpositions always result in differences divisible by 9 and the quotient of that figure (neglecting zeros) divided by 9 is the difference between the transposed figures. Thus, in the example given, the difference (\$86 — \$68) or \$18 divided by 9 gives a quotient of \$2 which ignoring the zeros, is the difference between the transposed figures 6 and 8. The zeros in the quotient indicate how many columns to the left the transposed figures are. In the case given the two zeros show that the transposition is between digits in third and fourth columns to the left.

8. Examine the folio columns of the books of original entry for posting references. Amounts without posting references should be traced immediately to the ledger.

9. Check the previous trial balance with the ledger. An offsetting error, for example, may have been made in a prior month, part of which has been corrected subsequently either on the books or on the later trial balance. It may then be necessary to go back over a prior month's accounts.

10. After exhausting these and other devices that may come to mind, the only remaining method is to recheck completely the postings to the accounts which were made during the period following the last trial balance. The best procedure is to check from the book of final entry to the books of original entry, which is the reverse of the method followed in the original posting.

11. It is never safe to charge off a small difference because such a difference may really mean a large debit less a large credit, or vice versa. Only in exceptional cases is it practicable to carry a difference forward with the hope that it will right itself or be found in the indefinite future.

Abstracting Journals.—When the procedure described above fails to reveal the error, a method referred to as abstracting the books of original entry may be used. This consists of repeating the entire posting of the period on work sheets which replace the ledger. For this purpose, analysis sheets as large as can be conveniently handled are used. The accounts of the ledger are set up on the sheets in skeleton or so-called T-form, as shown below:

Cash		Accounts Receivable		Sales	

The steps in the procedure from that point are as follows:

1. Transcribe to the skeleton accounts their respective balances at the beginning of the period.
2. Take a trial balance of the accounts to make sure that they were in balance at the beginning of the period.
3. Post all entries from the journals, entering only the amounts and references to the journals, thus:

Accounts Receivable

Balance	5,000.00	R. S.	500.00
S	25,000.00	C. R.	24,000.00
		J	1,000.00

4. When the posting is completed, ascertain the balance of each skeleton account and see whether it agrees with the balance in the general ledger account. If there is a discrepancy, compare the entries made in the skeleton account and in the ledger.

PROVING SUBSIDIARY LEDGERS

Verifying Agreement of Subsidiary Ledgers with Control Accounts—Procedure to Locate Error—Checking the Control Accounts

After a trial balance of the general ledger has been taken, it becomes necessary to verify the agreement of the subsidiary ledgers with their controlling accounts in the general ledger. If there is a discrepancy, it may be assumed for the time being that the controlling account is correct and that the error is in the subsidiary. To locate the error,

1. Refoot the abstract of the subsidiary ledger (see page 427) prepared when the subsidiary ledger was originally checked against the controlling account.
2. Check the accuracy of the transcription of the subsidiary ledger balances to the schedule.
3. Check the accuracy of the balances in the subsidiary ledger.
4. Check all postings to the subsidiary ledger from the journal, placing check-marks against the entries in the journals, and the subsidiary ledger accounts. Note if there are any unchecked items which have been omitted in posting the subsidiary ledger.

If no error is found in the subsidiary ledger, turn to the control account in the general ledger, verifying the postings from the special journals, and refooting the posted columns total in those journals.

CHECKING THE VOUCHERS PAYABLE ACCOUNT

Verifying Unpaid Items in Voucher Register Against Control Account—Procedure in Locating Any Error

Comparison with Unpaid Items in Voucher Register.—When the voucher register is used, no accounts with creditors are necessary either in the general ledger or any subsidiary ledger. The individual accounts owed creditors at any date may be determined from the Date Paid column of the voucher register. The open or unpaid items will not have any notations in this column. At the end of each month when the voucher register and check register are posted, these open items should be listed in a schedule and their total compared with the balance of the Vouchers Payable account in the general ledger, with which it should agree. If there is a difference, an error has been made.

Another method of verifying the balance in the Vouchers Payable account or the open items in the voucher register, is to take the file containing the unpaid vouchers and total these items. The total should agree with the balance in the Vouchers Payable account; and the individual vouchers should check against the open items in the register.

Procedure in Checking.—In locating the error, the following procedure may be used:

1. Verify the total of the Vouchers Payable column in the voucher register to see that the amount posted to the credit side of the Vouchers Payable account is correct.
2. Verify the total of the Vouchers Payable column in the check register to see that the amount posted to the debit side of the Vouchers Payable account is correct.
3. If there are any debits to Vouchers Payable in the Sundry Accounts Debited column in the voucher register, recording cancellation of vouchers on account of adjustments or for any other reason, verify the correctness of the posting of these debits to the Vouchers Payable account on the general ledger.
4. Working from the check register, which shows the numbers of all paid vouchers, see that notations for all such payments have been made in the Date Paid column in the voucher register.

5. If any vouchers are paid by means of a note, a notation should be made in the Date Paid column of the voucher register. Trace back all such notations from the entries made in the general journal debiting Vouchers Payable and crediting Notes Payable.

VERIFYING NOTES RECEIVABLE AND NOTES PAYABLE ACCOUNTS

Checking Accounts Against Note Register—Note Register Against Notes Receivable in Safe—Procedure to Find Error

Checking Notes Receivable Account.—The total amount of the open or unpaid items in the notes receivable register should agree with the balance of the Notes Receivable control account on the general ledger and with the notes on hand in the safe. If there is a discrepancy, it is due to some error, which is located by the following procedure:

1. Verify the fact that there is an entry in the notes receivable register for every note recorded in the journal as received from a customer in settlement of his account, or in the cash disbursements book for every note received for money loaned.
2. Check the notations in the Date Paid column of the notes receivable register for every note collected and recorded in the cash receipts book or otherwise canceled and recorded in the journal.

At the same time, it may be well to check the open items in the note register against the actual notes kept in a strong box or safe, as indicated above.

Checking Notes Payable Account.—The total amount of notes issued and still remaining unpaid as shown by the notes payable register should be in agreement with the Notes Payable control account on the general ledger. The cause of any disagreement may be traced as follows:

1. Verify the entry in the notes payable register for every note recorded in the voucher register or general journal as having been given in payment of an account, or for every note recorded in the cash receipts book as having been given for a loan of money.
2. Check the notations made in the Date Paid column of the notes payable register for every note paid and recorded in the cash disbursements book or check register.

ENTRIES TO CORRECT ERRORS

Fundamental Rule in Making Corrections—Methods of Correcting Mistakes—Their Advantages and Disadvantages

Manner of Making Corrections.—Since occasional mistakes are unavoidable, it is important to know how to correct them. One rule is fundamental: *Never erase or scratch out the original record,* because such altered or defaced books will not be admitted as evidence by courts. Mistakes may be corrected as follows:

1. Account name entered incorrectly but not yet posted. To correct, neatly rule out the incorrect name and insert immediately above the error, on the same line, the correct name thus:

Fred Smith
~~A. Andrews~~ $250.00

2. Amount entered incorrectly. To correct, neatly cross out the incorrect amount and insert the correct figure immediately above the error thus:

205.00
A. Andrews .... ~~$250.00~~

or

205.00
A. Andrews .... $~~250~~.~~00~~

Both the original and corrected items should be legible.

3. Transaction omitted through oversight. To correct, enter it under the current date indicating the correct date in the explanation, thus:

Jan. 15	John Smith	$30.00	
	Sales		$30.00
	Invoice #453 dated January 5 omitted		

4. Posting a debit to the credit side of a ledger account. To correct, neatly rule out the erroneous posting and record it on the debit side of that account.

5. Posting the debit amount but not the credit amount of an entry. To correct, post the omitted item.

6. Posting to the wrong ledger account. To correct, make a journal entry transferring the item to the correct account. Be sure to give an adequate explanation. Thus:

Jan. 31	Salaries	$10.00	
	Purchases		$10.00
	$10 salary item of January 23 debited to Purchases in error.		

When making such corrections apply the rule of debit and credit, that is, debit the account which should have been debited originally and credit the account which was debited in error.

7. Correcting complicated entries. When an error in principle or clerical work is discovered, the correcting entry may be made in either of two ways:

Reverse the entry actually made and make the entry which should have been made, or

Transfer the item from the account to which it has been posted to the account where it belongs.

To illustrate, assume a $250 collection was erroneously credited to Morton & Co. instead of to Davis Supply Co. The procedure to correct is as follows:

Under Method 1

Jan. 31	Morton & Co.	$250.00	
	Cash		$250.00
	Reverse entry made in error January 23.		
	Cash	$250.00	
	Davis Supply Co.		$250.00
	To record collection on January 23.		

Under Method 2

Jan. 31	Morton & Co.	$250.00	
	Davis Supply Co.		$250.00
	Correct error in entering cash receipts on January 23.		

Preferable Method.—Ordinarily the second method is preferable because less clerical work is required and it avoids showing the same receipt or disbursement twice where cash is involved and the same item twice where sales, purchases, etc., are involved. In case of complicated entries, the first method is preferable because in effect it crosses off on the books the original entry and substitutes the correct entry.

ADJUSTING ENTRIES BEFORE CLOSING OF BOOKS

Monthly Statements Prepared from Trial Balance—Classification of Adjusting Entries—General Procedure in Recording Closing Adjustments

Need of Taking a Trial Balance.—When the posting of the special journals and general journal has been completed, the general ledger must be in balance. It is the purpose of the monthly and annual trial balance to prove that this is so. The information contained on the trial balance is also used by many firms in preparing monthly profit and loss statements and balance sheets. Under the ordinary procedure of accounting, the books would be adjusted and closed monthly for this purpose, but this would require considerable detailed accounting work. Instead of recording these monthly adjusting and closing entries, the more acceptable plan today is to record them only on the work sheet at the end of each month. At the end of the year, however, the closing and adjusting entries for the previous months are combined into one total and are recorded on the books and the accounts are ruled off. It is thus seen that books may be closed both monthly and annually, but the usual custom is to record only the annual adjustment entries in the ledger.

Necessity for Adjusting of Certain Accounts.—Although the trial balance has been completed either monthly or annually, the ledger though in balance still does not show the exact condition of the business. It is necessary to add information not yet on the books and to adjust the values stated in some of the accounts in order that the exact condition of affairs will be set forth. Certain entries have been omitted temporarily, since it is understood that the adjustments will be made when the books are closed.

Accounts Requiring Adjustment Before Closing.—The accounts which will have to be supplied or will have to be adjusted preliminary to the closing, vary more or less with the type of business. In some kinds of businesses, they are quite numerous and more or less peculiar to the type of business. There are certain adjusting entries common practically to all businesses and these are given below.

The usual adjusting entries may be divided into four groups, as follows:

1. The adjusting entries required in the merchandising concern in order to set up on the books the closing inventory and thereby adjust the Cost of Goods Sold account. This entry would be:

Inventory	$30,000.00	
Cost of Goods Sold......................		$30,000.00
To record inventory on hand at end.		

2. Entries necessary to show the amount of depreciation charged on fixtures and furniture, delivery equipment, buildings and other assets, subject to depreciation and the amount of loss expected from uncollectible customers' accounts. These entries adjust the asset accounts to their present value. They are as follows:

Depreciation, Furniture and Fixtures	$280.00	
Depreciation Reserve, Furniture and Fixtures		$280.00
Depreciation, Delivery Equipment	750.00	
Depreciation Reserve, Delivery Equipment		750.00
Depreciation, Buildings	1,400.00	
Depreciation Reserve, Buildings		1,400.00
Bad Debts	482.00	
Reserve for Doubtful Accounts		482.00

3. Another group of adjusting entries includes those which show accrued income (see page 441) and accrued expense (see page 445) or the so-called accrual accounts:

Accrued Income:		
Accrued Interest Receivable	$150.00	
Interest Income		$150.00
Accrued Expense:		
Interest Cost	$ 50.00	
Accrued Interest Payable		$ 50.00
Royalties Expense	120.00	
Accrued Royalties Payable		120.00
Salaries	175.00	
Accrued Salaries		175.00
Wages	200.00	
Accrued Wages		200.00
Taxes	340.00	
Accrued Taxes		340.00

4. Entries which set up on the books the group of asset accounts commonly referred to as prepaid expense or deferred charges, and the group of liability accounts commonly referred to as prepaid income or deferred credits are as follows:

Prepaid Expense or Deferred Charges:

Prepaid Rent Expense........................	$ 50.00	
Rent Expense		$ 50.00
Advertising (Deferred)	300.00	
Advertising		300.00
Office Supplies (Deferred)..................	200.00	
Office Supplies		200.00

Prepaid or Deferred Income:

Rent Income	$ 50.00	
Prepaid Rent Income..................		$ 50.00

General Procedure in Making Adjusting Entries.—The general procedure in making and posting the foregoing adjusting entries is as follows:

First, indicate the entries in the two adjustment columns on the work sheet.

Second, make the entries in the journal from these two columns in the work sheet.

Third, post the journal entries in the ledger.

Fourth, take a trial balance of the ledger after the postings are completed to make certain that the ledger is in balance. This is the so-called adjusted trial balance.

When the adjusted trial balance shows that the ledger containing the adjusting entries is in balance—the total debit balances equaling the total credit balances—the ledger is complete in all particulars and is now ready for summarization or closing entries.

COST OF GOODS SOLD AT CLOSING

Why No Book Inventory Is Kept in Mercantile Concern—Procedure in Arriving at Cost of Goods Sold—Variations in Procedure

Recording Purchases and Sales During Year.—In the merchandising establishment, whether retail or wholesale, no record is kept of the cost of individual lots of goods sold, and it is, therefore, impossible to determine the profit on each sale. When goods are purchased, the Merchandise Purchases account is debited, and Accounts Payable is credited, with their cost. When a sale is made, the entry is simply a debit to Accounts Receivable and a credit to Sales for the amount of the sale. Thus, no record is maintained of the cost of the individual items of merchandise, but they are all lumped together in the one account of Merchandise Purchases. When they are sold, their withdrawal from stock is again not given separate bookkeeping treatment by charging inventory with the amount of their cost but they are entered at sales price.

The reason for this procedure is simply one of reducing the amount of the bookkeeping work. To maintain a running book inventory of the many varied lines of merchandise carried in stock by the average merchandising business would involve an expensive bookkeeping task which would hardly be warranted, especially since it is not absolutely necessary. For the ordinary mercantile concern, at the end of the year when the books are closed, it suffices if the profit on sales made during the year is ascertained in the aggregate or in one lump sum. For this purpose it is necessary to first find the aggregate cost of the goods sold.

Ascertaining Cost of Goods Sold.—The procedure in arriving at the cost of goods sold consists of the following steps:

1. Open an account entitled Cost of Goods Sold (or Cost of Sales, or Trading).

2. Debit Cost of Goods Sold with the following:

(a) With the stock of goods on hand at the beginning of the year, the amount of which was ascertained by taking a physical inventory and carried unchanged throughout the year in the Merchandise Inventory account. The full entry, which closes out the Merchandise Inventory account, is as follows:

Cost of Goods Sold............................	$10,125.67	
Merchandise Inventory		$10,125.67
To transfer beginning inventory to Cost of Goods Sold.		

(b) With the balance of the Merchandise Purchases account, by means of the following entry:

Cost of Goods Sold............................	$47,897.42	
Merchandise Purchases		$47,897.42
To transfer purchases to Cost of Goods Sold.		

(c) With the amount of the In-Freight and Cartage account by means of the following entry:

Cost of Goods Sold............................	$560.25	
In-Freight and Cartage..................		$560.25
To transfer balance of In-Freight and Cartage to Cost of Goods Sold.		

3. Credit Cost of Goods Sold with the following:

(a) With the stock of goods on hand at the close of the year, found by taking a physical inventory. The complete entry is as follows:

Merchandise Inventory	$11,267.40	
Cost of Goods Sold......................		$11,267.40
To transfer final inventory to Cost of Goods Sold.		

(b) With the amount of the Returned Purchases account by means of the following entry:

Returned Purchases	$2,125.40	
Cost of Goods Sold......................		$2,125.40
To transfer balance of Returned Purchases to Cost of Goods Sold.		

(c) With the amount of Purchase Rebates and Allowances account by means of the following entry:

Purchase Rebates and Allowances..............	$267.92	
Cost of Goods Sold......................		$267.92
To transfer balance of Purchase Rebates and Allowances to Cost of Goods Sold.		

4. Post all the foregoing entries and find the balance of the Cost of Goods Sold account, which will be on the debit side of the account. This balance is the cost of all sales made during the year.

The final step is to dispose of the Cost of Goods Sold account by closing it into Profit and Loss by means of the following entry:

Profit and Loss..................................	$44,922.62	
Cost of Goods Sold......................		$44,922.62
To close out.		

When the Cost of Goods Sold account is completely posted, it will appear as follows:

Cost of Goods Sold

19—						19—					
Dec.	31	Beginning Inv.		10,125	67	Dec.	31	Ending Inv.		11,267	40
		Purchases		47,897	42			Ret'd Pur.		2,125	40
		In-Frt. & Cart.		560	25			Pur. Reb. & Allow.		267	92
								Profit & Loss		44,922	62
				58,583	34					58,583	34

Variations in Procedure.—The foregoing illustrates the general procedure in ascertaining the cost of sales in a merchandising concern. Other methods may be employed but they are fundamentally the same. For example, the In-Freight and Cartage account might be closed out into the Merchandise Purchases account before the balance of the latter account is transferred to Cost of Goods Sold, particularly since in-freight and cartage is a part of the cost of goods purchased. Likewise, Returned Purchases and Purchase Rebates and Allowances might be closed first into Merchandise Purchases before the balance of the latter account is transferred to Cost of Goods Sold, so as to arrive at the net purchases made during the year. Moreover, instead of setting up a separate Cost of Goods Sold account, the Merchandise Purchases account might be used for the same purpose by transferring to it the balances of the other accounts with a resultant saving in a certain amount of bookkeeping labor. In that event the Merchandise Purchases account loses completely its original nature and is now in reality a Cost of Goods Sold account, though it is not entitled such.

MERCHANDISE INVENTORY ACCOUNT—AT CLOSING

The Beginning and Closing Inventory—Closing Inventory Accounts and Purchases into Cost of Goods Sold—Balance of Cost of Goods Sold Account

Beginning and Closing Inventories.—Most concerns engaged in merchandising business will have two inventories on the books at the time of closing. One of these, which is really a subdivision of the Purchases account, represents the inventory at the beginning, that is, the stock left over from the previous period. In preparing the profit and loss statement, this amount is added to the purchases to determine the amount of material that was available for sale during the period. A second inventory is known as the final inventory or closing inventory. This represents the amount on hand at the end of the fiscal period, that is, the date on which the books are closed. It is necessary to ascertain the final inventory, because when subtracted from the total available for sale during the fiscal period, it gives the cost of goods sold during the same period. Since the inventory at the beginning, the purchases made during the period, and the closing inventory are involved in the cost of goods sold, these accounts are closed into an account called Cost of Goods Sold. The journal entries are:

Cost of Goods Sold..............................	$ 2,000.00	
Inventory (Old)		$ 2,000.00
To transfer the inventory at the beginning to the Cost of Goods Sold.		

Cost of Goods Sold	$10,000.00	
Purchases		$10,000.00
To close the Purchase Account into the Cost of Goods Sold.		
Merchandise Inventory (New)	$ 7,800.00	
Cost of Goods Sold		$ 7,800.00
To place new inventory on the books and show its value in the Cost of Goods Sold account.		

Merchandise Inventory Account at Closing.—When this posting has been completed, the inventory in the beginning has been closed out, the Purchases account has also been closed and the new inventory is now on the books. The balance in the Cost of Goods Sold account represents the cost of merchandise during the period. The accounts will appear as follows:

INVENTORY

19— Jan.	1			2,000	00	19— Dec.	31	Cost of Goods Sold		2,000	00
Dec.	31	Cost of Goods Sold		7,800	00						

COST OF GOODS SOLD

19— Dec.	31	Inventory (Old)		2,000	00	19— Dec.	31	Inventory (New)		7,800	00
"	31	Purchases		10,000	00						

ACCRUED INCOME ITEMS—ADJUSTING ENTRIES

Nature of Accrued Income—Making the Adjusting Entry—Post-Closing or Reversing Entry—Care Necessary to Set Up All Accrued Items

Nature of Accrued Income.—In addition to the principal source of income or revenue, which in mercantile and manufacturing concerns is sales of merchandise or product, a business is usually in receipt of income from other, miscellaneous sources. The chief of these is interest received on loans of money, notes held, bonds, and even on customers' accounts in certain instances. Other examples of miscellaneous income are rent received from leased buildings and royalties received from licenses to use patents, from leased coal mines, oil fields, and the like.

Ordinary Method of Recording.—Income from such sources accrues, that is to say, is earned before it is actually paid. It is payable periodically, as quarterly, semi-annually, or annually. Nevertheless, between the date of the last payment and the date of the next payment, income has accumulated even though not paid. It is customary, however, merely as a matter of bookkeeping convenience, to record the income when payment is received, the entry then being, in the case of interest, as follows:

Cash	$30.00	
Interest Income		$30.00
Quarterly interest received on loan of $2,000 at 6% per annum to Thomas H. Jones.		

Adjusting Entry at Closing.—When, however, the books are closed and the date of closing does not coincide with the dates of payment of these miscellaneous forms of income, it is necessary to set up on the books the amounts that have accrued or been earned to the date of closing, even though they are not payable as yet, in order that the books may make a complete showing of income earned during the period. Assume, for example, that the quarterly dates for the payment of interest on the loan to Thomas H. Jones are February 15, May 15, August 15, and November 15. When the books are closed on December 31, a month and half's interest has accrued on the loan, amounting to $15, which, however, will not be paid until the following February 15. The entry to be made on December 31 is, therefore, as follows:

Accrued Interest Receivable	$15.00	
Interest Income		$15.00
Interest accrued to date on loan of $2,000 at 6% per annum to Thomas H. Jones.		

The Interest Income account is closed out to Profit and Loss in the usual way, charging Interest Income and crediting Profit and Loss. The Accrued Interest Receivable account is an asset account. It is in the nature of an account receivable, representing a sum of money owed to the concern, though its payment is not as yet due. Entries for accrued interest, together with other similar items of income, constitute one group of adjusting entries which the bookkeeper is obliged to make preliminary to closing the books.

Post-Closing or Reversing Entries.—The adjusting entry debiting Accrued Interest Receivable and crediting Interest Income is made so as to show at the time of closing the true financial condition of the business and the correct amount of net profits. Immediately after this purpose has been served, say January 1, the entry may be canceled by means of a so-called post-closing or reversing entry:

Interest Income	$15.00	
Accrued Interest Receivable.....................		$15.00
To reverse adjusting entry.		

When the reversing entry is posted, the Accrued Interest Receivable account will be closed out and will appear as follows:

Accrued Interest Receivable

1935 Dec.	31			15	00	1936 Jan.	1	Reversal		15	00

The Interest Income account when posted will appear as follows:

Interest Income

1935 Jan.	1	Reversal		15	00	1935 Dec.	31	(Total previously collected)		120	00
		To Profit & Loss		120	00					15	00
				135	00					135	00
1936 Jan.	1	Reversal		15	00						

The purpose of the post-closing or reversing entry is merely one of bookkeeping convenience. On the following February 15, when the quarterly interest payment is received, it will be merely necessary to debit Cash and credit Interest Income for the full amount of the payment as on other interest dates throughout the year. On the other hand, if the adjusting entry is not canceled by the reversing entry, when the quarterly payment of interest, amounting to $30, is received on February 15, the entry will be as follows:

Cash	$30.00	
Accrued Interest Receivable		$15.00
Interest Income		15.00
To record receipt of interest part of which was accrued on December 31.		

Part of the interest payment on February 15 is on account of accrued interest that was taken up on the books in the preceding December 31 in the Accrued Interest Receivable account. This account should, therefore, be credited with the amount, and thus be closed out. The balance of the interest payment should be credited to Interest Income account as usual.

Need of Entering All Items of Accrued Income.—Care should be taken that accrued income of every nature is entered on the books at closing. These items will not always be obvious and a special investigation of the notes, bonds, and other interest-bearing investments may be necessary.

Dividends received on any stock investment do not accrue when the books are closed, in the manner explained above, since dividends are payable only when declared by the directors of the corporation which has issued the stock.

INTEREST AND OTHER ACCRUED EXPENSES—ADJUSTING ENTRIES

Making Adjusting Entries and Closing into Profit and Loss—Reversing Entry—Common Types of Accrued Expense Items

Nature of Accrued Expenses.—Certain business expenses are incurred continuously or more or less so, but are paid only periodically—as quarterly, semi-annually, or annually. Between any two consecutive payment dates, these expenses accumulate, that is to say, they "accrue" and thus create a liability, in the nature of an account payable. A common example of such expense is that for interest on money borrowed. The amount of the interest expense keeps rising or accruing from day to day until the maturity of the loan, when it is paid, with the principal of the loan. If it is a long-term loan and interest is paid periodically, the interest accrues from one interest payment date to the next.

Entries for Interest Payment.—It would be possible to debit Interest Expense and credit Accrued Interest Payable, the liability account, with the amount of each day's accrual; and when payment of the interest is made, to debit Interest Payable Accrued, thus closing it out, and to credit Cash. Such procedure, however, would greatly increase the bookkeeping work and would serve no useful purpose. Therefore, a short-cut method is used so as to eliminate unnecessary bookkeeping. Except when the books are closed, no record is kept of the interest accruing between two successive interest dates, entry being made at the next interest date, when an instalment of interest is paid, as follows:

Interest Expense	$15.00	
Cash		$15.00
Quarterly interest at 6% per annum on $1,000 note, dated August 15, 19–, in favor of John H. Taylor.		

Adjusting Entry for Accrued Interest Payable.—However, when the books are being closed, account must be taken not only of every asset but of every liability as well, including that for interest which has accrued since the last interest-payment date and the payment of which is not due as yet. Suppose quarterly interest on the $1,000 note referred to in the journal entry given above was paid on November 15. The next payment will, therefore, not be due until the following February 15. When the books are closed on December 31, interest for a month and a half, amounting to $7.50, has accrued. This is a liability which must be taken up on the books in order to show the actual financial condition of the business and its actual earnings for the year. The following entry is therefore made:

Interest Expense	$7.50	
Accrued Interest Payable		$7.50
Interest accrued since November 15, 19–, at 6% per annum on $1,000 note, dated August 15, 19–, in favor of John H. Taylor.		

After this adjusting entry is posted to the Interest Expense account, it is closed out to Profit and Loss by the following entry:

Profit and Loss	$7.50	
Interest Expense		$7.50
To close out interest cost.		

Reversing Entry After Closing.—As soon as the books are closed, it is customary to cancel this entry, debiting Interest Expense and crediting Accrued Interest Payable, by means of reversing entry, also called post-closing entry, as follows:

Accrued Interest Payable	$7.50	
Interest Expense		$7.50
To reverse entry for interest payable accrued.		

After this entry is posted, the Accrued Interest Payable account is closed out and appears as follows:

ACCRUED INTEREST PAYABLE

1936						1935					
Jan.	1	Reversal		7	50	Dec.	31	Accrued		7	50

After the posting of the same entry, the Interest Expense account appears as follows:

INTEREST EXPENSE

1935						1935					
		(Total paid)		60	00	Jan.	1	Accrued		7	50
Dec.	31	Accrued		7	50	Dec.	31	Profit and Loss		60	00
				67	50					67	50
						1936					
						Jan.	1	Accrued		7	50

The purpose of the reversing entry is merely one of bookkeeping convenience. With the charge to Interest Expense and the credit to Accrued Interest Payable canceled in this manner, it will be only necessary to record the next interest payment on February 15 in the usual manner by simply charging Interest Expense and crediting Cash. On the other hand, if the entry for accrued interest is allowed to remain on the books, the entry to record the payment on February 15 will be as follows:

Interest Expense	$7.50	
Accrued Interest Payable	7.50	
Cash		$15.00
Payment of quarterly interest at 6% per annum on $1,000 note dated August 15, 19–, made to John H. Taylor.		

Accrued Rent Expense.—Other items which are treated in a manner similar to interest on money borrowed are rent owed, taxes, wages and salaries, and royalties owed. These charges are commonly referred to as accrued expenses, and give rise to one group of adjusting entries which it is necessary to make when the books are closed. If rent is paid monthly, but not in advance, and the date of payment does not coincide with the date for the closing of the books, the amount accrued since the previous payment must be set up as a liability on the books by the following entry:

Rent Expense	$125.00	
Accrued Rent Payable........................		$125.00
Rent accrued since December 15, 19–.		

Accrued Taxes.—Taxes are usually payable annually or semi-annually, and the amount accrued since the previous date of payment must be recorded by the following entry:

Taxes	$585.00	
Accrued Taxes		$585.00
Taxes accrued since March 1, 19–.		

Accrued Wages.—If wages are paid weekly on Wednesday, and the day on which the books are closed happens to be Monday, the amount earned by the workmen since the preceding Wednesday is a liability that must be recorded by the following entry:

Payroll	$386.00	
Payroll Accrued		$386.00
Accrual of payroll since December 26, 19–.		

Accrued Salaries.—If the monthly salaries are paid on the 15th of each month, one-half of the monthly total has therefore accrued when the books are closed, to record which the entry is as follows:

Salaries	$525.00	
Salaries Accrued		$525.00
Salaries accrued since December 15, 19–.		

Accrued Royalties.—If the concern pays royalties, the payments are likely to be made in several instalments throughout each year, and any accruals when the books are closed will be recorded like accrued interest payable.

PREPAID EXPENSE—ADJUSTING ENTRY

Recording Prepayment of Rent During Accounting Period—Adjustment at Closing—Reversing in Post-Closing Entry

Prepaid Expense Defined.—Prepaid expense is an expenditure of cash for a service which has not yet been rendered. It is equivalent to an advance of money and is in the nature of an account receivable, but differs from the ordinary account receivable in that it is to be repaid not in money but in a service of a stipulated kind and value. As such, it is an asset, but it is one that decreases in value with the rendering of the service.

A common example of prepaid expense is rent prepaid for a certain period of time. Rent paid in advance at the beginning of each month is an asset purchased with cash. It is a claim to a future service—one month's occupancy of the building. The asset is called Prepaid Rent. As the month expires, the value of this asset diminishes in proportion, until at the close of the month it is nil. With the repetition of the prepayment of rent at the beginning of the following month, the asset is again created, to be consumed again.

Entries for Prepayment of Rent.—If a continuous record were to be kept of this asset, at the beginning of each month as the prepayment was made, Prepaid Rent would be debited and Cash would be credited with the amount of the rent. At the close of each month, in order to record the annihilation of the asset, Rent Expense would be debited and Prepaid Rent would be credited with the amount of the monthly rent. However, such exactness in bookkeeping would serve little useful purpose and would simply cause unnecessary labor. For that reason during the accounting or fiscal year, it is customary, with each monthly payment, to make the entry:

Rent (Expense)	$100.00	
Cash		$100.00
Payment of rent for August.		

In other words, the prepayment is treated as an expense instead of an asset, as though it were not a prepayment, but a payment made for each month at its close.

Adjusting Entry at Close.—At the end of the fiscal or accounting period, however, when the books are closed, if a portion of the month for which rent was prepaid remains unexpired, there is an asset equal to a corresponding proportion of the monthly rental, and the rent expense is correspondingly less. This must be shown on the books if they are to reflect correctly the condition of the business and its profits for the year.

Assume that the monthly rental of $100 is prepaid on the 15th of each month and that the books are closed on December 31. The last rental payment before the closing was made, therefore, on December 15. As only half of the rental month has elapsed before the closing, only that proportion of the rental prepayment should be charged to Rent Expense. As the entire amount was so charged on December 15, in accordance with the usual procedure, an adjustment is necessary and this is effected by means of the following adjusting entry:

Rent Prepaid (asset account)	$50.00	
Rent (expense account)		$50.00
To adjust Rent account for unexpired rental of building and set up the asset.		

After the adjusting entry is posted to Rent, its balance amounts to 12 times the monthly rental charges of $100 each, less the $50 credited to the account by way of adjustment, which, however, is offset by a reversing debit of equal amount made at the beginning of the year. (See below.) The account is then closed out to Profit and Loss by means of the following entry:

Profit and Loss	$1,200.00	
Rent		$1,200.00
To close.		

Reversing Entry After Close.—After the books are closed, and under date of January 1 of the following year, it is customary to cancel the Prepaid Rent account by the following reversing entry:

Rent	$50.00	
Rent Prepaid		$50.00
To reverse adjusting entry.		

The account as so canceled and closed out will appear as follows when posted:

PREPAID RENT

1935					1936				
Dec.	31	Adjusting entry		50 00	Jan.	1	Reversal		50 00

The purpose of the reversing entry is simply a matter of bookkeeping convenience. If it were not made as of January 1, it would have to be made at the end of the rental month on January 15, in order to record the fact that the service for the prepaid rent was fully received. The reversing entry simply anticipates by a half-month the making of the entry, and the possible risk of overlooking it is avoided if it is made immediately after the books are closed.

After the reversing entry is posted to Rent, that account appears as follows, showing all entries made in the course of the year:

RENT

1935					1935				
Jan.	1	Reversing entry		50 00	Dec.	31	Prepaid rent		50 00
Jan.	15			100 00	Dec.	31	Profit and Loss		1,200 00
Feb.	15			100 00					
Nov.	15			100 00					
Dec.	15			100 00					
				1,250 00					1,250 00
1936									
Jan.	1	Reversing entry		50 00					

Prepaid Rent represents one of a group of similar adjusting entries which have to be made preliminary to the closing of the books in order that all assets resulting from prepayment of expenses may be set up and that charges for those expenses may be adjusted and correctly recorded.

UNEXPIRED INSURANCE—ADJUSTING ENTRY

Entries When Prepaid Insurance Is Carried as an Asset—When Treated as an Expense—Adjusting and Reversing Entries

Unexpired Insurance as a Prepaid Expense.—Unexpired or prepaid insurance differs from the usual prepaid expense because insurance is paid in advance for a longer period—one, two, three or five years. All prepaid expenses are assets, but, unlike the ordinary prepaid expenses which are treated as expense for convenience of bookkeeping except at the close of the accounting period, unexpired insurance is usually treated throughout as an asset. A special reason for this is the fact that if the insured were to cancel the policy, there would be a refund on a short-term basis. This would not be true of such an item as prepaid rent. However, as the policy expires from month to month, an expense has been created, which must be charged to Insurance Expense.

It is, therefore, better procedure to set up the asset account called Prepaid Insurance or Unexpired Insurance to record the payment of a premium and thereafter, at the end of each month or year when the books are closed, to charge off part of this asset to an account called Insurance Expense. In this way it avoids the necessity of making reversing entries at each closing and at all times the amount expended for insurance appears on the books as an asset. If, however, for the sake of consistency it is desired to treat the insurance expense in the same manner as the other prepaid expenses, the total amount paid is recorded as an expense and at the end of each period the unexpired portion is set up as an asset.

Adjusting Entries at the Closing—First Method.—Under the first method, the entries for the insurance when purchased and at the time of closing of the books are illustrated below. Assume that a three-year premium of $270 is paid on January 1. When the premium is paid, the entry is as follows, being, however, made in the cash disbursements journal or check register:

Unexpired Insurance	$270.00	
Cash		$270.00
Premium on fire insurance policy of $25,000 for three years.		

When the books are closed on December 31 following, one-third of the policy has expired. The actual expense incurred to date on account of insurance is, therefore, one-third of the premium paid, that is, $90. The remaining $180 constitutes the remaining asset of Unexpired Insurance. To record this fact, the following entry is made preparatory to closing the books:

Insurance Expense	$90.00	
Unexpired Insurance		$90.00
To record the amount of insurance expired.		

At this point, the Insurance Expense account will be closed into the Profit and Loss account by the following entry:

Profit and Loss......................................	$90.00	
Insurance Expense		$90.00

No reversal entry is necessary under this method of recording prepaid insurance.

The two insurance accounts when posted appear thus:

INSURANCE EXPENSE

19— Dec.	31	Expired insurance		90	00	19— Dec.	31	Profit and Loss		90	00
				90	00					90	00

UNEXPIRED INSURANCE

19— Jan.	1	Fire		270	00	19— Dec.	31	Expired insurance		90	00

Second Method of Making Adjusting Entries.—Under the second method, the following entries are made. Upon the payment of premium, the entry is as follows, being made in the cash disbursement book or check register:

Insurance Expense	$270.00	
Cash		$270.00
Premium on fire insurance policy of $25,000 for three years.		

When the books are closed on December 31, an adjusting entry is necessary preparatory to closing as follows:

Unexpired Insurance	$180.00	
Insurance Expense		$180.00
To set up Unexpired Insurance as an asset.		

At this point, the two accounts when posted appear as follows:

INSURANCE EXPENSE

19— Jan.	1			270	00	19— Dec.	31	Adjustment		180	00

UNEXPIRED INSURANCE

19— Dec.	31	Adjustment		180	00						

The Insurance Expense account is now closed into Profit and Loss account by the following entry:

Profit and Loss..	$90.00	
Insurance Expense		$90.00
To close.		

Immediately after closing the books under this method and under date of January 1, the following entry is made to reverse the adjustment.

Insurance Expense	$180.00	
Unexpired Insurance		$180.00

The reasons for this reversing entry or, as it is sometimes called, post-closing entry, are the same as in the case of any prepaid expense such as prepaid rent.

When the reversing entry is posted, the two accounts involved appear as follows:

INSURANCE EXPENSE

19— Jan.	1			270	00	19— Dec.	31	Adjustment		180	00
						"	31	Profit and Loss		90	00
				270	00					270	00
19— Jan.	1	Reversal		180	00						

UNEXPIRED INSURANCE

19— Dec.	31	Adjustment		180	00	19— Jan.	1	Reversal		180	00

TRAVELING EXPENSES AS PREPAID EXPENSE —ADJUSTING ENTRY

Entries to Set Up Unexpended Funds as an Asset—Reversing or Post-Closing Entry

Treatment Before Closing.—The cash advances made to salesmen to cover their traveling expenses are prepaid expenses, to be treated on the books in a manner similar to prepaid rent (see page 449). When the advances are made, they are considered to be expenses, and the entry is as follows:

Traveling Expenses	$150.00	
Cash		$150.00
Traveling expenses of J. B. Jones for May.		

Adjustment at Closing.—At the date of the closing of the books, however, an inventory is made of the amount of unexpended funds in the hands of the traveling salesmen. This amount of cash is an asset, a part of the general cash fund, and as it has been previously charged to Traveling Expense, the following adjusting entry is necessary to cancel the charge and include the amount in the Cash account:

Cash	$55.00	
Traveling Expenses		$55.00
To transfer unexpended traveling salesmen's funds to Cash.		

As thus adjusted, the Traveling Expenses account is closed out to Profit and Loss by the following entry:

Profit and Loss	$95.00	
Traveling Expenses		$95.00
To close.		

Reversing Entry.—Immediately after the closing, under date of the first day of the next fiscal period, the adjusting entry, debiting Cash and crediting Traveling Expenses, is reversed by the following entry:

Traveling Expenses	$55.00	
Cash		$55.00
To reverse adjusting entry.		

The purpose of this entry is to restore the two accounts to their status before the adjusting entry, so that the regular bookkeeping procedure may be resumed of simply debiting Traveling Expenses and crediting Cash with each advance as it is made to salesmen.

ADJUSTING ENTRY FOR DEFERRED CHARGES CARRIED FOR SEVERAL YEARS

Periodical Writing Down of Deferred Charges—Expense of Advertising Campaign as an Illustration—Deferred Charges in the Balance Sheet

Deferred Charge Set Up as an Asset.—Deferred charge or expense is but another name for prepaid expense (see page 449). It refers to an expenditure made for a service that is to be received in the future, and is therefore not an expense as yet but an asset. It will become an expense as the service is received. It is thus a postponed or deferred charge or expense, or, as it is sometimes referred to, a deferred debit.

The benefits of some prepaid expenses or deferred charges are received in full in a year or less. Such deferred charges are treated as expenses except when the books are closed (see page 449). In the case of other deferred charges, the benefits are expected to be enjoyed for a number of years, and the total charge is set up as an asset and written off annually in instalments. Thus, an extensive advertising campaign may be taken as calculated to yield benefits for three years and its cost will therefore be set up as an asset by the following entry:

Deferred Charge to Advertising....................	$600.00	
Cash		$600.00
Cost of advertising campaign carried as a deferred charge.		

At the end of each of the three years, preliminary to the closing of the books, the following adjusting entry will be made in order to indicate the amount of service received, or expense incurred, which in each case is one-third of the original cost:

Advertising Expense	$200.00	
Deferred Charge to Advertising..............		$200.00
To charge off one-third of the deferred expense of advertising campaign amounting to $600.		

The Advertising Expense account may also contain in each year other current charges for advertising. The account will be closed out to Profit and Loss by the following entry:

Profit and Loss	$385.65	
Advertising Expense		$385.65
To close.		

At the end of the third year, the cost of the advertising campaign will be completely charged off and the account, Deferred Charge to Advertising, will be closed out.

Deferred Charges on the Balance Sheet.—On the balance sheet, sometimes all the deferred charge accounts are lumped together into one item entitled "Deferred Charges," since they are usually for comparatively small amounts.

PREPAID INCOME—ADJUSTING ENTRIES

Usual Procedure in Recording—Adjustment at Closing—Reversing or Post-Closing Entry

Prepaid Income Defined.—Prepaid income is income received for services which have not been rendered as yet. The service is paid for in advance of its receipt. A common example of such income is monthly rent received in advance. Until the tenant has had the enjoyment of the occupancy of the building for the month, the prepayment of the rental is in the nature of an advance made by him which is to be repaid, not in cash, but by permitting him the use of the building rented. Prepaid income to the landlord is prepaid expense to the tenant, and whereas the landlord will record the amount prepaid as a liability, it represents an asset on the books of the tenant. (See "Prepaid Expense.") Other examples of prepaid income are insurance premiums received in advance by insurance companies and royalties received in advance by owners of patents. Other designations for prepaid income are deferred income or deferred credits.

Customary Procedure in Recording.—The obvious method of recording the prepayment of rent received by the landlord on the first of each month is to debit Cash and credit Prepaid Rent Income, a liability account, and at the close of the month to debit Prepaid Rent Income and credit Rent Income. However, as frequently happens in bookkeeping, a short-cut method is used instead. In place of making one entry at the beginning of the month and another at the end, only one entry is made at the beginning of the month, as follows:

Cash	$100.00	
Rent Income		$100.00
Monthly rental received.		

By this procedure, the fact that the rental is prepaid and gives rise to a liability is ignored. It is treated as earned income from the very outset. This method of recording produces the same result as two entries described in the preceding paragraph.

Adjusting Entry at Closing.—When, however, the books are being closed, consideration must be given to the fact that the rental was prepaid and may therefore represent in part a liability. Suppose the monthly rental of $100 is paid on the first of each month and the books are closed as of September 15. On the closing date, half of the rental received still remains prepaid, or unearned, and therefore $50 of the $100 payment credited to Rent Income on September 1 must be set up as a liability called Prepaid Rent Income.

The journal entry to make the adjustment by this method is as follows:

Rent Income	$50.00	
Prepaid Rent Income.....................		$50.00
To transfer unearned rent to a deferred credit account.		

The Rent Income account as thus adjusted is closed out to Profit and Loss by the following entry:

Rent Income	$1,200.00	
Profit and Loss...........................		$1,200.00
To close.		

Reversing Entry After Closing.—After the books are closed and under date of September 16, the following entry is made reversing the adjusting entry:

Prepaid Rent Income............................	$50.00	
Rent Income		$50.00
To reverse the adjusting entry.		

The purpose of this reversing or post-closing entry is simply by way of returning at once to the short-cut method of recording prepaid income. This reversing entry merely anticipates a similar entry which otherwise would have to be made at the close of the month when the total amount of the monthly rental was earned.

When the reversing entry is posted, the Prepaid Rent Income will be closed out and will appear as follows:

PREPAID RENT INCOME

1936 Sept.	16	Reversal		50	00	1936 Sept.	15	Deferred		50	00

At the same time, the Rent Income account will appear as follows:

RENT INCOME

1936 Sept.	15	Deferred		50	00	1935 Sept.	16	Deferred		50	00
	15	Profit and Loss		1,200	00			(Total year's rentals)		1,200	00
				1,250	00					1,250	00
						1936 Sept.	16	Deferred		50	00

STEPS TAKEN IN CLOSING BOOKS

Reasons for Closing Books—When Books Are Closed—Successive Steps by Which Closing Is Effected

When Books Are Closed.—Books of account are closed in order to ascertain, first, the financial condition of the business, which will be shown in the balance sheet, and secondly, the results of the year, that is, the profit made or loss sustained, which will be shown in the profit and loss statement. The books are closed at the end of each fiscal accounting year, which may or may not correspond to the calendar year. Most businesses close their books as of December 31 of each year, but many close them as of some quarter-yearly date, as March 31, June 30, or September 30. Moreover, the closing may be more often than once a year.

General Procedure in Closing.—The procedure to close the books consists of the following steps:

1. Take a preliminary trial balance of the general ledger. This is the usual monthly trial balance (see page 419).
2. Prepare, enter, and post the necessary adjusting entries, using the work sheet for this purpose (see page 462). (For a list of accounts that ordinarily must be adjusted upon the closing of the books, see page 434.)
3. Take an inventory of the stock of merchandise on hand at the close of the period, and find the cost of sales made during the year (see page 436).
4. Make the closing entries by transferring all expense and income accounts, or the so-called nominal accounts, to the Profit and Loss account (see page 466).
5. Transfer the balance in the Profit and Loss account to Proprietor's Capital account in the case of a business owned by a single person (see page 467); or to the partners' Capital accounts, in the case of a partnership

(see page 470); or to the Surplus account in the case of a corporation (see page 469).

6. Transfer the balance in the single proprietor's Drawing account to his Capital account (see page 470); or in the case of a partnership, transfer the balance in the Drawing account of each partner to his respective Capital account (see page 470).
7. Rule off all nominal accounts, which are balanced and closed into Profit and Loss (see page 470).
8. Rule such balance sheet accounts as desired and bring down the balances (see page 470).
9. Reverse such adjusting entries as require reversal. (Treated under various adjusting entries.)
10. Take a post-closing trial balance of the general ledger (see page 474).
11. Prepare balance sheet and profit and loss statement from the work sheet (see pages 475 and 481).

THE WORK SHEET AT CLOSING

Eight, Ten, and Twelve-Column Work Sheet—Detailed Procedure in Preparation—Relation of Work Sheet to Books of Account

Function of the Work Sheet.—The work sheet is a "tool" commonly employed by the bookkeeper to facilitate his work in closing the books. It serves two main purposes:

First, to indicate the adjustments to be made in the ledger accounts preliminary to closing the books and insure their correctness before they are formally entered in the journal. The work sheet is the basis for these entries.

Second, to control the work incident to drawing up the final statements—the balance sheet and profit and loss statement. These statements are, in common practice, prepared directly from the work sheet and not from the ledger, simply because of the greater convenience and assurance of accuracy.

Account Name	Preliminary Trial Balance		Adjustments		Adjusted Trial Balance		Profit and Loss		Balance Sheet	
	Debits	Credits	Debits	Credits	Debits	Credits	Debits	Credits	Debits	Credits
Cash in Bank	$ 6,584.14	$ –	$ –	$ –	$ 6,584.14	$ –	$ –	$ –	$ 6,584.14	$ –
Petty Cash Fund	50.00	–	–	–	50.00	–	–	–	50.00	–
Notes Receivable	800.00	–	–	–	800.00	–	–	–	800.00	–
Notes Receivable Discounted	–	300.00	–	–	–	300.00	–	–	–	300.00
A. D. Taylor & Company	200.00	–	–	–	200.00	–	–	–	200.00	–
Land	2,500.00	–	–	–	2,500.00	–	–	–	2,500.00	–
Furniture and Fixtures	500.00	–	–	–	500.00	–	–	–	500.00	–
Auto Truck	700.00	–	–	–	700.00	–	–	–	700.00	–
B. Peterson & Company	–	535.00	–	–	–	535.00	–	–	–	535.00
Western Milling Company	–	2,200.00	–	–	–	2,200.00	–	–	–	2,200.00
Notes Payable	–	1,000.00	–	–	–	1,000.00	–	–	–	1,000.00
Mortgage Payable	–	1,000.00	–	–	–	1,000.00	–	–	–	1,000.00
A. Brown, Capital	–	10,000.00	–	–	–	10,000.00	–	–	–	10,000.00
A. Brown, Drawing	300.00	–	–	–	300.00	–	–	–	300.00	–
Sales	–	4,118.75	–	–	–	4,118.75	–	4,118.75	–	–
Sales Returns & Allowances	281.25	–	–	–	281.25	–	281.25	–	–	–
Purchases	6,558.75	–	–	–	6,558.75	–	6,558.75	–	–	–
Purchase Returns & Allowances	–	153.75	–	–	–	153.75	–	153.75	–	–
Freight-In	64.50	–	–	–	64.50	–	64.50	–	–	–
Store and Office Salaries	325.50	–	(1) 55.00	–	380.50	–	380.50	–	–	–
Rent	150.00	–	–	–	150.00	–	150.00	–	–	–
Delivery Expense	104.15	–	–	–	104.15	–	104.15	–	–	–
Sundry Expense	49.00	–	–	–	49.00	–	49.00	–	–	–
Insurance Expense	108.00	–	–	(5) 105.00	3.00	–	3.00	–	–	–
Interest Expense	11.61	–	(2) 2.50	(6) 9.33	4.78	–	4.78	–	–	–
Discount on Sales	36.00	–	–	–	36.00	–	36.00	–	–	–
Interest Income	–	1.50	–	(4) .67	–	2.17	–	2.17	–	–
Discount on Purchases	–	13.90	–	–	–	13.90	–	13.90	–	–
Totals	$19,322.90	$19,322.90	–	–	–	–	–	–	–	–
Unexpired Insurance			(5) 105.00	–	105.00	–	–	–	105.00	–
Prepaid Interest			(6) 9.33	–	9.33	–	–	–	9.33	–
Accrued Interest Receivable			(4) .67	–	.67	–	–	–	.67	–
Accrued Salaries			–	(1) 55.00	–	55.00	–	–	–	55.00
Accrued Interest Payable			–	(2) 2.50	–	2.50	–	–	–	2.50
Taxes			(3) 10.00	–	10.00	–	10.00	–	–	–
Accrued Taxes			–	(3) 10.00	–	10.00	–	–	–	10.00
Depreciation			(7) 25.00	–	25.00	–	25.00	–	–	–
Reserve for Depreciation of Auto Truck			–	(7) 15.00	–	15.00	–	–	–	15.00
Reserve for Depreciation of Furniture and Fixtures			–	(7) 10.00	–	10.00	–	–	–	10.00
Bad Debts			(8) 20.59	–	20.59	–	20.59	–	–	–
Reserve for Bad Debts			–	(8) 20.59	–	20.59	–	–	–	20.59
Merchandise Inventory			–	–	–	–	–	3,646.25	3,646.25	–
Totals			$ 228.09	$ 228.09	$19,436.66	$19,436.66	–	–	–	–
Subtotals							$ 7,687.62	$ 7,934.82	$15,395.39	$15,148.09
Net Profit							247.80	–	–	247.30
Totals							$ 7,984.82	$ 7,934.82	$15,395.89	$15,395.89

Ten-Column Work Sheet

The preparation of the work sheet represents, therefore, the first step in the whole closing process.

General Form and Columnar Arrangement.—An illustrative work sheet is shown on the preceding page. The work sheet is prepared on "analysis" paper ruled to provide columns for the following:

1. Account titles
2. Trial balance items
3. Adjustment items
4. Adjusted trial balance
5. Profit and loss items
6. Balance sheet items

The work sheet is not a part of the formal accounting record. It is more in the nature of a schedule supporting the adjusting entries and the financial statements. As it is a "work sheet" and not a final record, in which erasures may be made and corrections effected, it is common practice to insert figures in pencil.

After the adjustments have been entered in the journal from the work sheet and the financial statements have been prepared, the work sheet should be filed away in a separate folder marked "Closing Work Sheets" or "Work Sheets with Adjusting Entries," or some similar designation, for future reference should the occasion for it arise. In the work sheet shown on the preceding page, provision is made for ten amount columns, and it is called a ten-column work sheet. When the adjusting entries are not numerous, the two columns for the adjusted trial balance may be omitted, in which case the work sheet is an eight-column work sheet. On the other hand, in a manufacturing concern it is generally advisable to show the costs of manufacture in separate columns, and when that is done the work sheet will have twelve columns.

Routine Procedure in Preparing Work Sheet.—The steps to be taken in preparing the work sheet are given below.

Heading:

(a) Name of business.

(b) Name of statement, that is, Ten-Column Work Sheet.

(c) Date of statement, that is, January 31, 19–.

Account Name column:

(d) List the ledger accounts comprising the trial balance.

Preliminary Trial Balance columns:

(e) In the debit and credit columns, list the items comprising the preliminary trial balance.

(f) Foot the columns independently to make certain that the debits equal the credits and that no errors have been made in copying.

Adjustment columns:

(g) Post the adjusting entries into these columns. List additional accounts as needed.

(h) Place before each debit and credit the number of the adjusting journal entry supporting it. This facilitates reference to the journal entries if necessary to trace an error or ascertain additional information.

(i) Foot the columns to make certain the debits equal the credits.

Adjusted Trial Balance columns:

(j) Each trial balance figure adjusted by the related debits and credits in the adjustment columns is extended into the adjusted trial balance columns. The procedure is illustrated by Insurance. The debit of $108 less the credit of $105 equals a debit of $3 which is recorded on the same line under the Adjusted Trial Balance.

(k) Foot the columns to make certain that the debits equal the credits.

Closing inventory:

Record as a debit in Balance Sheet section and a credit in Profit and Loss section.

Profit and Loss columns; Balance Sheet columns:

(l) The debits and credits appearing in the Adjusted Trial Balance columns are sorted. Those which will appear in the balance sheet are listed in the debit and credit columns headed Balance Sheet; those which will appear in the profit and loss statement are listed in the debit and credit columns headed Profit and Loss.

(m) Show sub-totals for the four columns.

(n) Ascertain and record the balancing figures in the Profit and Loss section and in the Balance Sheet section. The two are identical if the clerical work is correct.

(o) Foot the four columns to make certain that the debits equal the credits.

MAKING THE CLOSING ENTRIES

Closing Entries Grouped to Represent Successive Steps in Closing—Closing of Income and Expense Accounts into Profit and Loss—Profit and Loss into Capital Account

The Several Steps in Making the Closing Entries.—The closing entries can be made only after the necessary changes and corrections have been made in the ledger accounts by means of the adjusting entries. The closing entries may be divided into three groups representing successive steps at this particular stage of the general process of closing the books:

First, entries by which certain accounts representing deductions from sales, such as Sales Returns and Allowances, are transferred to Sales, so as to arrive at the net amount of sales for the period.

Second, the entries by which the balances of all revenue and income accounts are transferred to the credit side of the Profit and Loss account and the balances of all cost and expense accounts are transferred to the debit side of the Profit and Loss account.

Third, the entry or entries by which the balance of the Profit and Loss account (a profit if a credit balance and a loss if a debit balance) is transferred to the Surplus account in the case of a corporation, or to the Capital account in the case of an individually owned business, or to the Capital accounts of the partners, in the case of a partnership.

Arriving at Net Sales Figure.—Several entries may be included in the first group, made in transferring the balances of accounts representing deductions from sales, to the Sales account in order to arrive at the net sales. But in many businesses there may be only one entry, which is as follows:

Sales	$1,850.00	
Sales Returns and Allowances..........		$1,850.00
To close Sales Returns and Allowances into Sales.		

Closing Income and Expense Accounts into Profit and Loss.—The second group of entries, representing the second step in the summarization of accounts at closing, consists of the following:

Sales	$193,150.00	
Profit and Loss........................		$193,150.00
To close Sales into Profit and Loss.		
Profit and Loss........................	$134,450.00	
Cost of Goods Sold....................		$134,450.00
To close Cost of Goods Sold into Profit and Loss.		

(See discussion, page 436.)

Profit and Loss		$25,225.00	
Salesmen's Salaries			$13,675.00
Selling Supplies and Expense			1,400.00
Advertising			4,500.00
Out-Freight			400.00
Delivery Expense			3,300.00
Depreciation			1,950.00
Store Furniture and Fixtures	$1,200.00		
Delivery Equipment	750.00		
To close selling expense accounts into Profit and Loss.			
Profit and Loss		$18,560.00	
Office Salaries			$ 5,100.00
Office Expense			4,500.00
General Expense			2,000.00
Printing and Stationery			600.00
Taxes			3,180.00
Insurance			1,500.00
Depreciation			1,680.00
Office Furniture and Fixtures	$ 280.00		
Building	1,400.00		
To close general administrative expense accounts into Profit and Loss.			
Profit and Loss		$ 2,367.88	
Interest Cost			$ 950.00
Sales Discount			850.00
Collection and Exchange			85.00
Bad Debts			482.88
To close financial expense accounts into Profit and Loss.			
Interest Income		$ 1,650.00	
Purchase Discount		1,300.00	
Rentals Income		600.00	
Profit and Loss			$ 3,550.00
To close financial management income items into Profit and Loss.			

The following points should be noted in examining the above series of entries:

1. The various expense accounts are classified into several groups—selling, general administrative, and financial. The accounts for miscellaneous income are also grouped as financial management income.

2. To save bookkeeping work, the total of expense accounts in each group are summarized. There is then only one debit to the Profit and Loss for the total instead of individual debits for the balances of each account in the group. The balances of the miscellaneous income accounts are likewise summarized, and only one credit for the total is made to the Profit and Loss account instead of an individual credit for each account.

In small concerns, however, where expenses and income are not classified in much detail, the individual items composing the group totals above are often transferred directly to the Profit and Loss account.

3. The order of the entries follows as much as possible that of the corresponding items as they appear on the profit and loss statement.

When the foregoing entries, constituting the second group of closing entries, are posted, Profit and Loss account will contain on the credit side the amounts of all revenue or income accounts, and on the debit side the amounts of all cost and expense accounts. The balance of the Profit and Loss account, if a credit, will therefore represent a net profit; and if a debit, will represent a net loss.

Closing Profit and Loss Account into Surplus or Capital Accounts.—The final step in making the closing entries is to transfer the balance of the Profit and Loss account to the Surplus account in the case of a corporation, or to the Capital account in the case of a business owned by a single individual, or to the Capital accounts of the several partners in the case of a partnership.

In the case of a corporation, the entry is as follows, the balance of the Profit and Loss account in the above illustration being a credit:

Profit and Loss..................................	$16,097.12	
Surplus		$16,097.12
To close Profit and Loss into Surplus.		

In the case of a single proprietorship, the final closing entry is:

Profit and Loss	$14,447.12	
T. R. Smart, Capital		$14,447.12
To close Profit and Loss to Capital account.		

In the case of a partnership, the final closing entry is as follows:

Profit and Loss	$ 7,373.56	
R. J. Taylor		$ 3,686.78
T. M. Smart		3,686.78
To close Profit and Loss into Partners' Capital accounts.		

Closing Drawing Account of Single Proprietor or Drawing Accounts of Partners into Capital Accounts.—When the business is a single proprietorship or a partnership (not a corporation), the second group of entries, closing income and expense accounts into Profit and Loss, would contain an entry or entries for closing the proprietor or partners' Personal or Drawing accounts into the Capital accounts, as for example:

T. R. Smart, Capital	$3,478.53	
T. R. Smart, Personal		$3,478.53
To close Personal account into Capital account.		

Ruling Off Closed Accounts.—When the foregoing closing entries are posted to the ledger, the accounts that have been closed into Sales and into Profit and Loss are balanced and closed and should be double-ruled in the ordinary manner of closed accounts. The Profit and Loss account having been closed into the Surplus account, in the case of a corporation, will also be ruled, and will appear as set forth in form following.

After the posting of these closing entries has been completed, the accounts that still remain open on the ledger are those which represent assets, liabilities, and proprietorship.

Profit and Loss

19—					19—				
Dec.	31	Cost of Goods Sold	134,450	00	Dec.	31	Sales	193,150	00
		Selling Expenses	25,225	00			Financial Management Income	2,950	00
		Administrative Expenses	18,560	00			Sub-Rentals Income	600	00
		Financial Manage-Expenses	2,367	88					
		Surplus	16,097	12					
			196,700	00				196,700	00

Profit and Loss Account in Ledger

Variations in Method of Closing.—The method of making closing entries as explained above is not one that may not be departed from in any particular. As a matter of fact, it can be varied in different ways though the final result will be the same. For example, instead of closing the Sales Returns and Allowances into Sales, the account may be closed directly into Profit and Loss, but in that case there will be no account on the ledger whose balance will represent the net sales, as the Sales account does when all accounts representing deductions from the gross sales amount are first closed into Sales. The bookkeeper should strive to master one specific method of making the closing entries. Thereafter, he will have no difficulty in making whatever variations in the method that may seem desirable in view of the conditions under which he is working.

PROFIT AND LOSS ACCOUNT

Approved Practice in Connection with Profit and Loss Account—Subdivision of the Account into Several Sections

General Function of Profit and Loss Account.—The part played by the Profit and Loss account in making the closing entries is explained and illustrated in the discussion of those entries on page 467. The account is a summarizing or clearing account, representing an intermediate step in effecting the closing entries. Its main function is to show by its balance the result of operations since the previous closing—the net profit or net loss. These results are also shown in the profit and loss statement. The cost and expense accounts, and the sales and other income accounts might be closed directly into the Surplus account of a corporation, instead of first into Profit and Loss. There are, however, two objections to such practice: First, there would be no one place on the ledger where the net profit or net loss for the fiscal period would be shown, and that profit or loss for the period could be obtained only by making a calculation, finding the difference between the balance of the Surplus account just before and just after these closing entries. Second, it is desirable not to overburden the Surplus account with numerous debits and credits, many of which would not by themselves have any special significance. The same objections hold to closing out the income and expense accounts directly into the Capital account of the single properietor. In a partnership, the Profit and Loss account is necessary because the net profit or loss must be determined before it can be distributed to the Capital accounts of the several partners.

Good practice requires that the Profit and Loss account should be confined to its function as purely a summarizing account when making the closing entries. It should not be used for current entry during the accounting period.

Subdividing the Profit and Loss Account.—If considered desirable, the Profit and Loss account may be subdivided into several sections, whose balances will show:

Gross profit
Net selling profit
Net profit on operations
Net income to surplus, or the final net profit

As thus subdivided, the form of the Profit and Loss account would be as shown in the illustration below on this page. Note that it is subdivided into what are virtually four accounts. Into the first, the Sales and the Cost of Goods Sold are posted. It is then balanced to show the gross profit of $58,700. The account is then ruled up at this point and the balance is brought down on the credit side as indicated. In the next section of the Profit and Loss account, the entries closing the selling expense accounts are posted, and the account is again balanced off to show the net selling

PROFIT AND LOSS

19—					19—				
Dec.	31	Cost of Goods Sold	134,450	00	Dec.	31	Sales	193,150	00
		Gross Profit—down	58,700	00					
			193,150	00				193,150	00
Dec.	31	Salesmen's Salaries	13,675	00	Dec.	31	Gross Profit—down	58,700	00
		Selling Supp. & Exp.	1,400	00					
		Advertising	4,500	00					
		Out-Freight	400	00					
		Delivery Expense	3,300	00					
		Depreciation	1,950	00					
		Net Selling Profit—down	33,475	00					
			58,700	00				58,700	00
Dec.	31	Office Salaries	5,100	00	Dec.	31	Net Selling Profit—down	33,475	00
		Office Expense	4,500	00					
		General Expense	2,000	00					
		Printing & Stat'ry	600	00					
		Taxes	3,180	00					
		Insurance	1,500	00					
		Depreciation	1,680	00					
		Net Profit on Operations—down	14,915	00					
			33,475	00				33,475	00
Dec.	31	Interest Cost	950	00	Dec.	31	Net Profit on Operations—down	14,915	00
		Sales Discount	850	00			Interest Income	1,650	00
		Bad Debts	482	88			Purchase Discount	1,300	00
		Collection & Exch.	85	00			Rentals Income	600	00
		Net Income—to Surplus	16,097	12					
			18,465	00				18,465	00

The Profit and Loss Account Subdivided

profit, or the profit of $33,475 after deduction of the selling expenses as well as the cost of goods sold. The regular closing rulings are again inserted and the balance brought down. In the third section, entries closing the administrative expense accounts are posted. The account is again balanced off to show a net profit on operations of $14,915, or the net profit before the deduction of certain financial and non-operating items and additions of miscellaneous income. This balance is again brought down, and after the entries for the remaining expense and income accounts are posted and the account balanced off, the amount of $16,097.12 is shown as the final net profit figure. Such an account closing approximates closely the form of the profit and loss statement.

POST-CLOSING TRIAL BALANCE

Proving Ledger in Balance After Closing—Locating Errors Disclosed by Post-Closing Trial Balance

After the closing and post-closing or reversing entries have been posted and the ledger accounts balanced and closed, a new trial balance of the general ledger should be taken to make certain that the ledger is in balance, that is, that equal debits and credits are carried forward to the next period. This trial balance is referred to as the "post-closing" trial balance. Since the closing process transfers all nominal accounts to the Capital or Surplus account, the closing trial balance contains only real accounts—asset, liability, and proprietorship accounts. The items on this trial balance should correspond with those listed in the balance sheet section of the work sheet. The drawing accounts and profit figures are combined with the proprietorship accounts on the ledger in the case of a single proprietorship or partnership, or with the Surplus account in the case of a corporation. If the post-closing trial balance discloses that the ledger is not in balance, the error or errors must lie in the work which followed the preparation of the work sheet. In attempting to locate the error, therefore, it is necessary to trace the adjusting entries made in the journal from the work sheet, and posted from the journal to the ledger, and the closing and post-closing entries made directly in the journal and posted to the ledger.

PREPARING THE BALANCE SHEET

Making Balance Sheet Understandable to Management—Account and Report Form of Balance Sheet—Grouping and Arrangement of Items

Balance Sheet Prepared from Work Sheet.—The balance sheet of a business is one of the two financial statements prepared when the books of account are closed. It is referred to as Exhibit A by the public accountant. It is a statement of the financial condition of the business at that time, setting forth: (1) the assets, (2) the liabilities to creditors, and (3) the total capital investment of the proprietor, or of the partners, or of the stockholders in the case of a corporation. The balance sheet is prepared from the last two columns of the work sheet, which contain all the balance sheet items. It is, therefore, the ledger summarized after the books have been closed, with all adjusting and closing entries posted. The last two columns of the working sheet constitute, in fact, the balance sheet. However, before presenting it on a separate sheet to the management or to any other interested parties, such as the stockholders, or prospective lenders of money, or in the case of a large corporation, the investing public, it is necessary to reduce it to a more understandable form by grouping together related items, captioning the several groups, and arranging them in a desirable order.

Two General Forms of Balance Sheet.—The balance sheet may be presented in two general forms. The following form (a) presents a balance sheet arranged in two columns—the assets in the left-hand column and the capital and liabilities in the right-hand column. This is known as the account form of balance sheet. The other form of the balance sheet is shown in form (b). Here the entire balance sheet is arranged in one column, the Assets section appearing first, followed by the Capital and Liabilities section. This is called the report form of balance sheet. The first form is the one usually adopted.

Heading of the Balance Sheet.—The balance sheet should be headed to show:

1. The name of the business for which it is prepared, that is to say, the name of the proprietor, partnership, or corporation.
2. The character of the statement, namely—Balance Sheet.
3. The date as of which it is prepared, namely—the date of the closing of the books. This date is essential because the situation represented by the balance sheet changes as soon as new transactions occur.

The balance sheet, in the heading, is often referred to by other titles, as follows:

1. Financial Statement.
2. Statement of Condition
3. Statement of Resources and Liabilities
4. Statement of Assets and Liabilities
5. Statement

Arrangement of the Balance Sheet—Asset Side.—The usual arrangement and grouping of the items of a balance sheet is indicated in the account form on page 477. The left or asset side is divided into three sections, captioned respectively, Current Assets, Prepaid Expenses, and Fixed Assets. The Current Assets consist of cash and the assets which will be converted into cash usually within a year in the

Exhibit A

A. Brown

Balance Sheet—January 31, 19–

Assets

Current Assets:			
Cash—			
On Deposit	$6,584.14		
Petty Cash Fund...	50.00	$6,634.14	
Receivables—			
Notes Receivable ($800 less Dis. Notes $300)	$ 500.00		
Accrued Interest ..	.67		
Customers' Accounts	200.00		
	$ 700.67		
Less—Res. for Bad Debts	20.59	680.08	
Merchandise Inventory		3,646.25	
Total Current Assets................			$10,960.47
Prepaid Expenses:			
Unexpired Insurance		$ 105.00	
Prepaid Interest		9.33	114.33
Fixed Assets:			
Land		$2,500.00	
Auto Truck	$ 700.00		
Less—Res. for Depr.	15.00	685.00	
Office Furniture and Fixtures	$ 500.00		
Less—Res. for Depr.	10.00	490.00	3,675.00
Total All Assets..................			$14,749.80

Liabilities and Capital

Current Liabilities:		
Notes Payable	$ 1,000.00	
Accounts Payable	2,735.00	
Accrued Salaries	55.00	
Accrued Interest	2.50	
Accrued Taxes	10.00	
Total Current Liabilities.............		$ 3,802.50
Fixed Liabilities:		
Mortgage Payable (Due in five years)....		1,000.00
Capital Account:		
Balance at January 1, 19–......	$10,000.00	
Add—Net Profit for January, Exhibit B	247.30	
Total	$10,247.30	
Less—Withdrawals	300.00	
Balance at January 31, 19–..............		9,947.30
Total Liabilities and Capital........		$14,749.80

(a) Account Form of Balance Sheet

A. BROWN *Exhibit A*

BALANCE SHEET—JANUARY 31, 19–

ASSETS			
CURRENT ASSETS:			
Cash—			
On deposit	$ 6,584.14		
Petty Cash Fund	50.00	$ 6,634.14	
Receivables—			
Notes Receivable ($800 less discounted notes $300)	$ 500.00		
Accrued Interest	.67		
Customers' Accounts	200.00		
	$ 700.67		
Less—Reserve for Bad Debts	20.59	680.08	
Merchandise Inventory		3,646.25	
Total Current Assets			$10,960.47
PREPAID EXPENSES:			
Unexpired Insurance		$ 105.00	
Prepaid Interest		9.33	114.33
FIXED ASSETS:			
Land		$ 2,500.00	
Auto Truck	$ 700.00		
Less—Reserve for Depreciation	15.00	685.00	
Office Furniture and Fixtures	$ 500.00		
Less—Reserve for Depreciation	10.00	490.00	3,675.00
TOTAL ASSETS			$14,749.80
LIABILITIES			
CURRENT LIABILITIES:			
Notes Payable	$ 1,000.00		
Accounts Payable	2,735.00		
Accrued Salaries	55.00		
Accrued Interest	2.50		
Accrued Taxes	10.00		
Total Current Liabilities		$ 3,802.50	
MORTGAGE PAYABLE (Due in five years)		1,000.00	
TOTAL LIABILITIES			$ 4,802.50
NET WORTH			
CAPITAL ACCOUNT:			
Balance at January 1, 19–	$10,000.00		
Add—Net Profit for January, Exhibit B	247.30	$10,247.30	
Less—Withdrawals		300.00	
Balance at January 31, 19–			9,947.30
TOTAL LIABILITIES AND CAPITAL			$14,749.80

(b) Report Form of Balance Sheet

ordinary course of business, namely, accounts and notes receivable, accrued income and merchandise. Prepaid Expenses are grouped separately because they are peculiar accounts, representing claims for future services, payment for which has been made in advance. Sometimes, however, they are included with Current Assets. The Fixed Assets section comprises the assets which constitute the operating equipment of the business. If there are other assets not falling into these groups, they may be added under the caption of "Other Assets."

Liability Side of Balance Sheet.—There is also a threefold division of the items on the Capital and Liability side of the balance sheet. The first group includes the Current Liabilities, consisting of debts contracted usually for less than a year. Fixed Liabilities, or the second section, is comprised of liabilities running for upwards of a year. The third section of this side of the balance sheet comprises the Net Worth items of the business.

If the business is a partnership, the net worth section may be presented in the following form:

Net Worth:		
J. L. Taylor	$5,670.00	
T. M. Briggs	4,832.00	$10,502.00

In a corporation, the net worth section will consist of at least two items, Capital Stock and Surplus, and may be presented in the following form:

Net Worth:		
Capital Stock	$10,000.00	
Surplus	3,467.83	$13,467.83

It is frequently desirable to set forth in the balance sheet the number of shares of stock issued and the par value of each, or the fact that they are without par value. Also, if there is more than one class of stock outstanding, there should be a separate Capital Stock item for each. These data may be set forth in balance sheet in the following form:

Capital Stock:	
Preferred—Par Value $50.00	
Authorized and issued—100 shares	$ 5,000.00
Common—No Par Value	
Authorized and issued—1,000 shares	10,000.00
Total Capital Stock	$15,000.00
Surplus	6,832.97

Order of Item as Governed by Their Relative Liquidity.—In mercantile and manufacturing businesses, the asset and liability groups are ordinarily arranged in the order of their liquidity, or their ease of being converted into cash, and the same arrangement is followed for items within each group. Thus with respect to current assets, cash—the most liquid asset—is placed first, then receivables, then inventory, and so on. The arrangement of "from the most to the least liquid" is preferable. Current assets and current liabilities are the important factors in the balance sheet. Other arrangements of the balance sheet items may be used when fixed assets constitute the most important group, as in the case of railroads and public utilities.

Details to be Observed in Preparation of Balance Sheet.—In connection with the subject of balance sheet construction, note that the capitalization of certain words, the use of group headings, the indentations under group headings, and the arrangement of the columns aid materially in bringing out the essential facts. The ideal is to set out important facts and relationships so clearly that they will not be overlooked even by the casual reader.

Other Terms Used in the Balance Sheet.—The customary captions employed on the balance sheet are those given in the preceding forms.

Other captions sometimes used are:

Floating Assets—as a synonym for Current Assets.
Capital Assets—as a synonym for Fixed Assets.
Floating Liabilities—as a synonym for Current Liabilities.
Capital Liabilities—as a synonym for Fixed Liabilities.
Deferred Charges—a broader term, covering more items than might be included under "Prepaid Expenses."
Quick Assets or Liquid Assets—frequently used as a synonym for Current Assets, though it should be limited to cash and assets readily convertible into cash.
Resources—as a synonym for Assets.

PREPARING THE PROFIT AND LOSS STATEMENT

Essential Items in Statement—Account and Report Forms—Various Designations of Statement—Supporting Schedules

Two Forms of Profit and Loss Statement.—The profit and loss statement summarizes the results from operations for an accounting period—the various items of revenue or income, including sales, the various items of outgo, or cost and expense, and the final net profit or loss for the period. It is referred to as Exhibit B by the public accountant. The statement is prepared at the time of the closing of the books from the profit and loss columns of the work sheet. In drawing up the statement, the items in these columns can be combined and summarized to any degree desired.

In arrangement of the items, the profit and loss statement may take either one of two forms. One is the account form, in which items of income are listed on the right side of the statement, and items of cost and expense on the left side of the statement. In this form the statement is practically a reproduction of the profit and loss account after the closing entries are posted to it. This form, however, is seldom used.

Exhibit B

A. Brown

Statement of Profit and Loss

Month Ended January 31, 19–

Particulars	Amount	
Gross Sales	$4,118.75	
Less—Sales Returns and Allowances	281.25	
Net Sales		$3,837.50
Deduct—Cost of Goods Sold:		
Purchases	$6,558.75	
Less—Purchase Returns and Allowances	153.75	
Net Purchases	$6,405.00	
Less—Inventory at January 31, 19–	3,646.25	2,758.75
Gross Profit on Sales		$1,078.75
Deduct—Operating Expenses:		
Store and Office Salaries	$ 380.50	
Rent	150.00	
Delivery Expense	104.15	
Freight Inward	64.50	
Sundry Expenses	49.00	
Insurance Expense	3.00	
Taxes	10.00	
Depreciation	25.00	
Bad Debts	20.59	806.74
Net Profit from Operations		$ 272.01
Deduct—Financial Income & *Expense* (Net):		
Discount on Sales	$ *36.00*	
Purchase Discount	13.90	
Interest Earned	2.17	
Interest Expense	*4.78*	*24.71*
Net Profit to Capital Account (Exhibit A)		$ 247.30

Report Form of Profit and Loss Statement

Much more common is the report or narrative form of the statement as illustrated in the above form. In this form the statement brings out more clearly the following essential points, that should be expressed in every profit and loss statement:

1. Net Sales—measuring the volume of business.
2. Gross Profit—representing the excess of the sale price over Cost of Goods Sold.
3. Operating Expenses—being the cost of conducting the business.
4. Net Profits from Operations—representing gross profit minus operating expenses.
5. Any other income or expense.
6. Surplus Net Profits—being the amount remaining after adjusting net profits from operations for any other expenses or income.

Heading of the Statement of Profits.—The heading of the statement of profits should set forth:

1. The name of the business for which the statement is prepared.
2. The nature of the statement, that is, Statement of Profits, Statement of Profit and Loss, etc.
3. The period covered by the statement, as month, quarter-year, half-year, year ending as of a certain date, or from one date to a following date.

In practice the statement is variously designated, the titles more commonly employed being:

1. Statement of Profit and Loss
2. Statement of Profits
3. Statement of Profits and Income
4. Income Account
5. Statement of Revenue and Expenses
6. Statement of Income and Expenses

Instead of the word "statement," the word "summary" is occasionally used in these titles.

Supporting Schedules.—If the statement of profits covers more than one page its essential points may easily be overlooked. Consequently it is preferable to transfer the details under cost of sales or the details of the operating expenses to separate schedules, if that is necessary to secure clearness and precision. The statement will then represent a condensed statement of profit and loss, and the details will be shown in the supporting schedules.

SPECIAL POINTS ON THE PREPARATION OF FINANCIAL STATEMENTS

Points as to Form, Arrangement, Indentation, and Rulings—Rules to be Observed in Preparation of Statements

Points to be Observed in Drawing Up Statements.—It is difficult to state absolute rules for preparing financial statements since many items may be treated in more than one way. However, the bookkeeper will find that observing the points of technique listed below will assist him in drafting statements in acceptable form.

General:

1. Do not abbreviate ordinarily. Financial statements are formal documents.
2. Show no unexplained figures. The executive is not necessarily a skilled accountant. So do not allow for misunderstanding.
3. Start writing close to the margin line. Develop neat, even margins.
4. Be consistent in the use of margins. Place the most important items at the left-hand margin and indent each subdivision uniformly two or more spaces. The spaces should be of sufficient size to make the indentations well defined.
5. Underlining headings and important items makes them stand out.
6. Do not crowd the items. Use enough paper to make an attractive looking statement.

7. Do not split a statement between two sheets of paper. If the statement is too large for one sheet, use condensed figures supported by detailed schedules on separate sheets.
8. Number the exhibits and schedules and "tie them together." Schedules supporting the balance sheet are numbered A-1, A-2, etc. Schedules supporting the profit and loss statement are numbered B-1, B-2, etc. Thus, the profits statement and the balance sheet may be "tied up" through cross-referencing the surplus net profits item.
9. Draw double lines across the money columns below the last figures on the statement.
10. Show dollar signs, at the head of column figures in the statements.
11. Center the heading of each exhibit.

Balance Sheet:

12. Do not show "Balance Sheet for the Year Ending . . . ." A balance sheet is as of a specific date, as for example, "at December 31, 19–."
13. Where only one item appears in any division, caption heading and total for that division are unnecessary. Simply write the item in capital letters and extend its amount to the total column.
14. Show "Total Current Assets" and "Total Current Liabilities." This emphasizes the working capital amount which is an important figure, especially if the balance sheet is to be used for credit purposes.
15. Show the following accounts as deductions from their related assets:
    (a) Notes Receivable Discounted—deduction from notes receivable.
    (b) Reserve for Bad Debts—deduction from accounts and notes receivable.
    (c) Reserve for Depreciation—deduction from the fixed assets.

16. Analyze the net worth section thus:
    (a) Balance at beginning of period (specify date).
    (b) Profits for period (make a reference to the profit and loss statement).
    (c) Drawings for period if a single proprietor or partnership.
    (d) Balance at close of period (specify date).
17. Put grand totals on account form balance sheets opposite each other, i.e., on the same horizontal line.

Profit and Loss Statement:

18. Do not show "Profit and Loss Statement—December 31." A profit and loss statement covers a period of time and that period (month, quarter, half-year, year, etc.) must be clearly indicated in statement heading.
19. Specify the dates of the inventory figures shown in the profit and loss statement.
20. Use condensed figures for Cost of Goods Sold, Operating Expenses, etc. (supported by detailed schedules on separate sheets of paper) only when necessary to avoid cumbersome statements. In so far as possible, information should be presented on one sheet.

Use of Term "Financial Statement."—Care is necessary in the use of the term "financial statement," when used in the plural or singular number. "Financial statements" commonly applies to both balance sheet and profit and loss statement. The singular form, "financial statement," has usually reference to the balance sheet alone, particularly when it is used for purposes of obtaining credit or bank loans.

Filing of Financial Statements.—Some attention should be given to the permanent filing of copies of both statements. The number of copies that may have to be prepared will depend upon the particular requirements of the general management. A larger number of copies will be needed in a partnership than in a single proprietorship, as a copy will have to be prepared for each partner. Before the directors' or the stockholders' meeting of a corporation, quite a number of copies may be required. But copies of the statements prepared at each closing of the books should be placed in a file for the permanent use of the management. A flexible binder serves this purpose very well.

ORGANIZATION OF THE OFFICE

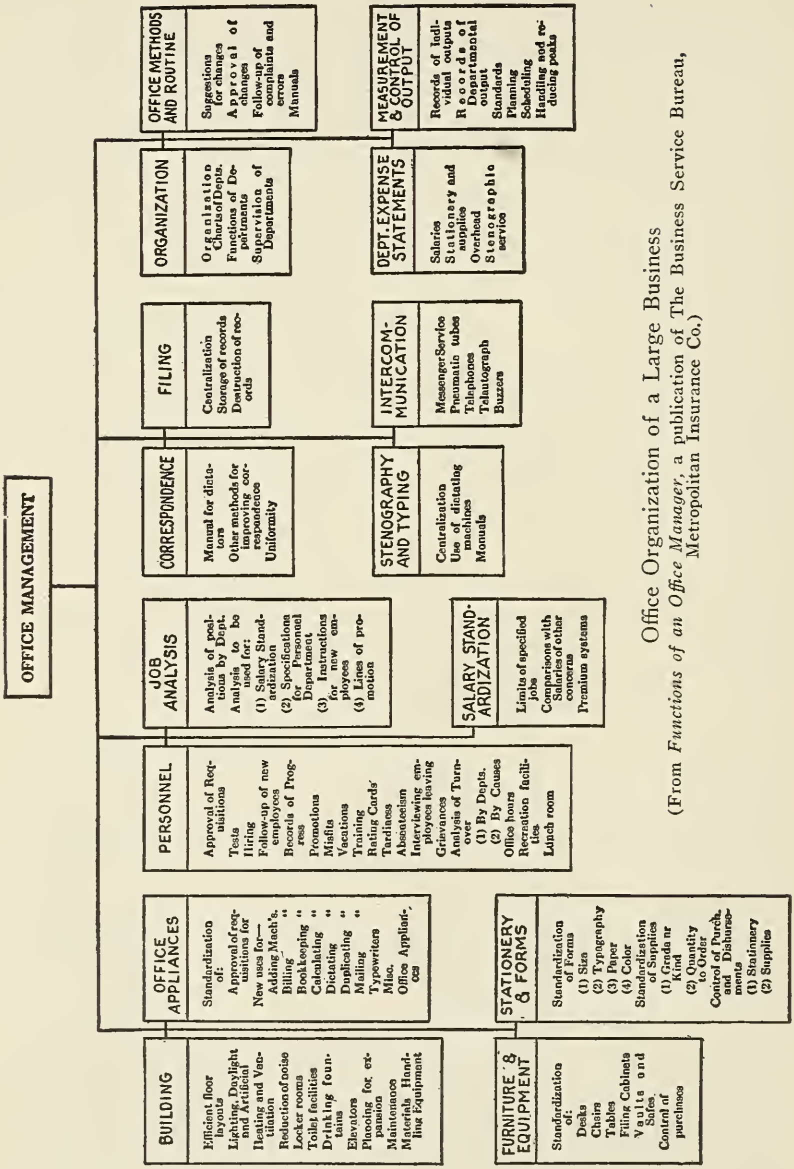
Various Lines Along Which Organization May be Effected—Chart Illustrating Complete Organization of a Large Office

The office organization of particular business establishments varies greatly because of the size of the business and the different character of the work performed in each. Thus, the office of one business may be subdivided into the following departments:

1. An office service department which is responsible for centralized correspondence, house service and maintenance, stationery and records, telegraph, telephone, mailing, employees' personal purchases, messengers, photostating and blue-printing.
2. An accounting department in charge of the bookkeeping, expense analysis, auditing of disbursements, billing and payroll.
3. A personnel department in charge of the employment and general personnel activities.

Another company may have its office work organized on the basis of the three major functions of the business: sales, manufacturing, and financial.

A more complete analysis of the organization of the office work may be secured by studying the illustration on the following page, which shows the present recognized detail and control of the various activities carried on in a large office. In a smaller organization, such a detailed set-up would not be needed.



Office Organization of a Large Business
(From *Functions of an Office Manager*, a publication of The Business Service Bureau, Metropolitan Insurance Co.)

FLOW OF WORK IN AN OFFICE

Simple Method of Correcting Faulty Office Organization—Purchase Order as Illustrating Flow of Work in an Office

Causes of Uneven Flow of Work.—The term "flow of work" in an office refers to the passage of work through the hands of the various operators. Thus, a sales order is handled by several individuals in an office. The work performed in connection with an order by each individual in turn constitutes the flow of work as regards sales orders. Uneven flow of work usually results in some of the employees waiting for work while others are overloaded with work. This will be due to faulty planning of office organization resulting in uneven distribution of work. There may be too much wasted time during the early hours in the morning, or there may be unnecessary breaks in the passage of work from one department to another resulting in less prompt attention to orders, correspondence, and the like. Sometimes the calendar causes an uneven flow of work. For example, Monday may bring in a flood of work from all parts of the country, and Tuesday may show a dearth of such activity. The half Saturday will usually be heavy at a time when workers are interested in leaving early for the week end. A little careful planning will usually help correct such situations. One of the simplest methods of correcting faulty office organization is to make a floor plan of the office with the location of the desks indicated on it. Lines are then drawn to show the routes along which the office work will flow. If the lines cross each other frequently, it may be necessary to rearrange the desks, in order to eliminate this condition.

Illustrating the Flow of Work in an Office.—In most offices, activities center around a few types of transactions such as purchases, sales, cash receipts, cash payments, and manufacturing. Each type of work will constitute a separate flow of work. The following illustrates the flow of work in connection with a purchase order:

FLOW OF THE PURCHASE ORDER

1. A purchase requisition may be made out by:
   (a) The purchasing agent.
   (b) The credit manager and given to the purchasing agent.
   (c) The head accountant who needs supplies.

2. The purchasing agent's department prepares a copy of the purchasing requisition in duplicate:
   (a) The duplicate copy is filed numerically.
   (b) The original is given to a clerk.
   (c) The clerk using the information on the requisition makes out the purchase order in quadruplicate (using different colored paper for each copy, such as: original white, duplicate yellow, triplicate pink, quadruplicate blue).
   (d) The original is sent to the vendor.
   (e) The duplicate is attached to the original purchase requisition and is filed alphabetically in the purchasing agent's unfilled order file.
   (f) The triplicate is sent to the receiving clerk so that he may know what material to expect.
   (g) Quadruplicate is filed by the purchasing agent, numerically.

   The number of copies of the purchase order may vary from two to six or more, depending upon the organization.

3. The receiving and shipping clerk files the triplicate copy of the purchase order in his file. This is filed numerically.
   (a) When the purchases are received, the receiving and shipping clerk compares the goods received with the copy of the purchase order. He may prepare a receiving report, or he may merely check off the items on the triplicate copy of the purchase order. In

either case, the O.K.'d copy of the purchase order or a copy of the receiving report is sent to the purchasing department to notify it that the goods have been received.

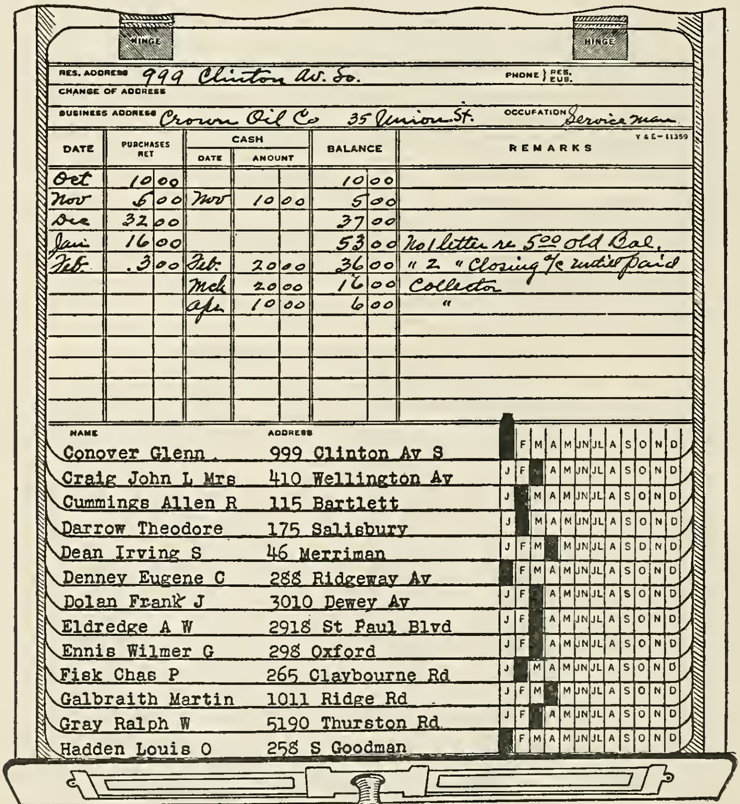
4. The incoming invoice of the goods purchased is sent to the purchasing department where a comparison is made with the receiving report. If all the goods have been received satisfactorily, the invoice is O.K.'d as to the quantity and price of the materials. The invoice is then sent to the accounting department.
5. The accounting department checks all extensions and totals on the invoice. A voucher form is then prepared (see page 157) and entered in the voucher register. The unpaid voucher and invoice are filed in an unpaid voucher file until payment is made.
6. When the voucher check is signed and mailed to the creditor, an entry is made in the check register and the purchase has been completed and paid for.

FILING IN THE OFFICE

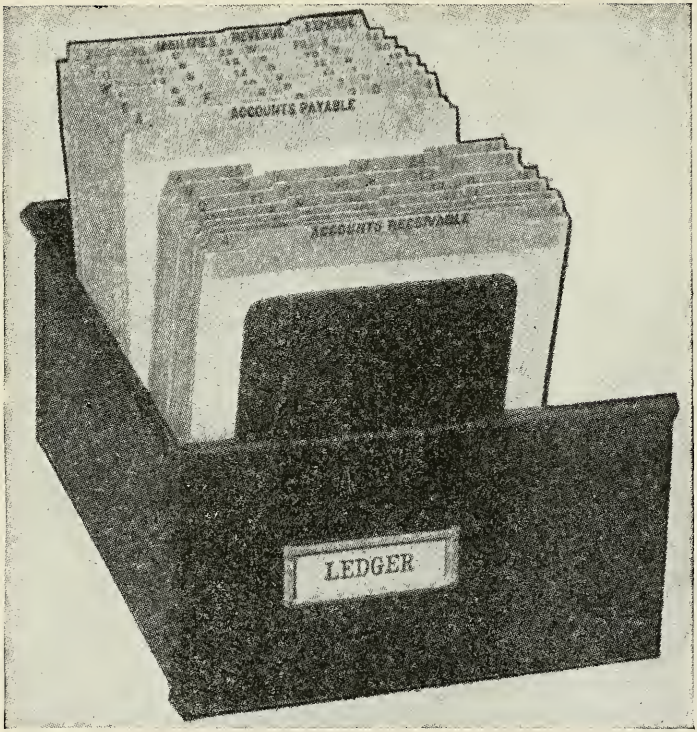
Filing Accounting Records—Check Files—Transfer of Files by Continuous Method—Organization of Executives' Private Files

The Purpose of Filing.—Filing is a procedure used in business offices whereby business papers and accounting books are stored in an orderly arrangement so that they may be quickly found when needed, and may be properly safeguarded when not in use. The files consist of cabinets of wood or steel, containing drawers with guide cards and folders to facilitate the placing and finding of the stored material. If the papers are placed on edge, the files are called vertical files; if the papers are laid flat, the files are called horizontal files. Correspondence which bulks heaviest of all filed material is placed in one file, while business papers, accounting records, and documents are placed in special files. The special files include such accounting records as accounts receivable ledger cards, invoices of sales and purchases; voucher check files; loose-leaf accounting records, and executive records.

Use of Files for Bookkeeping Records.—Every employee in a business office uses the correspondence files. These are usually centralized and placed in charge of a capable supervisor. The accounting records must be kept in separate or



(a) Visible Index for Keeping a Record of Customers' Accounts



(b) Special File Tray for Customers' Accounts

special files. One special file, for example, is the visible index shown in form (a), which is a traylike arrangement used to keep a record of the accounts receivable prepared by pen and ink. By the use of the colored metal tabs attached to the cards, it is possible to indicate which accounts are delinquent; it also provides a better system of follow-up. Where the accounts receivable are prepared on a posting machine (see page 501), a special file tray is used, form (b). This procedure permits easy withdrawal of the file from the safe in the morning and its return to the safe at the close of the day.

Check files are usually of a special size—low but wide. The checks are filed in numerical order, whereas the ledger accounts receivable files are arranged alphabetically. Detailed information about filing methods can be secured from manufacturers of filing equipment located in most large cities.

A third important file for the bookkeeper's use is that of the perpetual inventory. The perpetual inventories today are kept either in books with loose-leaf sheets or on cards in special files. Therefore, the perpetual inventory may be kept in a visible index file arranged alphabetically, or in box files, usually of the 5″ x 7″ size.

Transfer of Files.—Whenever the accumulated material in the files becomes obsolete or too bulky, it is necessary to transfer part of it to storage files. This is known as "transferring the files." Since the accounting records are necessary for future reference both for the firm and for revenue tax purposes, it is an important problem for the bookkeeper to know how and when to transfer the records. Although there are several methods of transferring records in general, bookkeeping records are usually transferred by what is known as the continuous method. By this method the files are never completely cleaned out, but as fast as the material reaches a certain age or becomes entirely obsolete, it is transferred to the other files. Since the ledger cards of customers, the perpetual inventory, and other bookkeeping records are used daily, the only system of transfer for accounting records is by this continuous method. Thus, when a customer has not made a purchase for a considerable period, his card is placed in the inactive file; also, when a ledger card becomes filled, it is placed in the transfer file.

The Private File.—There is usually one executive in every organization whose files are filled with confidential matters and intimate details of the private transactions which it is necessary to keep from the employees and other unauthorized persons. The arrangement within the cabinet of such a file might be as follows:

Code Number	Description
1.0	Executive Matters
.1	Organization Plans
.2	General Executive Meetings
.3	Branch Matters
.4	Branch Manager Bonus Arrangements
.5	
.6	
etc.	
2.0	Directors' Meetings
.1	By-Law Requirements
.2	Board of Directors
.3	New Business
.4	Unfinished Business
.5	Resolutions
.6	Copies of Minutes
.7	
.8	
etc.	
3.0	Financial
.1	Bond Issues
.2	Stock Issues
.3	Treasury Stock
.4	Bank Balance
.5	Bank Signatures
.6	Notes Payable
.7	Accounts Payable
.8	
.9	
etc.	
4.0	General Sales and Operating Policies
5.0	Insurance and Leases
6.0	Credits and Collections
7.0	Accounting and Internal Routine
8.0	Statistics
9.0	Personnel
10.0	Branch No. 1
11.0	Branch No. 2

Each of the last eight items may be subdivided as in the case of items 1, 2, and 3. The private file is of particular interest to a bookkeeper because many of his records are kept in such a file, including financial statements, minutes of directors and corporate meetings, credit details, and the like.

INCOMING AND OUTGOING MAIL

Handling Letters Containing Remittances—Handling Outgoing Mail—Economies to be Effected in Mailing—Postal Information

An important phase of office work concerns the mailing of letters, forms, reports, statements, and checks, as well as the receipt of mail. To some extent this work concerns the bookkeeper, depending upon the size and organization of the office.

Handling Incoming Mail.—Mail comes either from the post-office letter carrier, or the company messengers. It is opened by hand or machine, depending on the volume. Whether mail addressed to individuals should be opened depends on the policy of the company. The majority of firms have mail which is addressed to individuals, delivered directly to them unopened. All letters containing checks or cash are either (1) put in a separate file for direct delivery, or (2) put in one lot for the cashiers' department, or (3) the money is detached and a notation made on the face of the letter stating the amount enclosed. If this last method is followed, a separate clerk must be employed to enter on a special form, the remittance sheet, the name of the customer from whom money has been received and the amount received. The mail is sorted by departments, sections, and in some cases according to individuals. Some companies make a practice of time-stamping all the incoming mail as it is sorted. After the mail has been sorted by departments, it is then ready for delivery by messengers to the various departments.

Handling Outgoing Mail.—The methods of handling outgoing mail are: (a) messengers periodically collect outgoing mail from outgoing letter trays or baskets on the desks in the various departments; (b) upon receipt of outgoing mail in the mailing room, it must be folded, inserted in envelopes, sealed, and stamped. Particular care must be taken to be sure that all enclosures which accompany the letter are actually inserted. Large mailing departments find it advantageous to make use of folding, sealing, and stamping machines. Sealing and stamping machines may be obtained which operate by hand or electricity as the volume of the work may warrant. In recent years the so-called postage meter machine, which prints a "postage paid" symbol on the envelope, has supplanted to a certain extent the stamping machine which automatically placed actual stamps on the letter.

Economies in Mailing.—In mailing as well as all other office activities, it is necessary to keep the cost down to a minimum. The following rules will be of assistance in keeping down the mailing expense, which if care is not taken may assume large proportions.

1. Eliminate from the mailing list the names of prospects whose letters are returned by the post office as "not found."
2. Have proper control over the issuance and the use of stamps.
3. The use of a single office envelope for sending out each day's mail from the head office to the district or branch. By the use of the latter method all letters going to a given branch office or salesman are held in the mailing room till the end of the day when they are forwarded in one envelope. Duplication of postage, as well as additional envelopes and effort are thus saved.

Postal Information.—Postal information may be secured from regulations issued by the Post Office Department. Following are special points of such information:

1. A money order is payable at office drawn on, and within thirty days at any other office subject to a fee.

2. When the sender of a letter desires to recall it, he addresses a second envelope, the duplicate of the first, and rushes with it to his postmaster, who will give him Form 1509 to fill in. The duplicate is required for identification. The post-office gets in touch with the station to which the first letter has been sent and with the carrier who would naturally deliver it. Letters to distant points are wired or even cabled for. The sender must pay for this, but for letters stopped at the station of mailing, or within the city, there is no charge.

3. There is now a way to get from the post-office the new address of a person lost track of. A forwarding address, hitherto held inviolate by the post-office, may now be had by sending a letter "registered mail, return receipt showing address where delivered." It costs 20 cents more than the ordinary return—receipt registered mail—but many business firms and individuals take advantage of this service.

4. A certificate of mailing for ordinary mail of any class may be had at the local post-office for one cent. It shows date and place of mailing, name and address of sender and person addressed; and is useful as proof of mailing income tax checks, legal notices, etc.

5. Many people have a mistaken idea that it helps the post-office if they place the address on both sides of a package. As a matter of fact, it delays the transmission of the package; when the distributor sees an address but no stamp, he sets aside the package to be held for postage-due examination.

6. The post-office's greatest handicap is that people do not mail their letters earlier in the day, business offices especially depositing a great flood of mail at five o'clock in the afternoon or later. There is, in consequence, delay in the post-office in forwarding mail, which in many cases means that a letter goes on a later evening train than it should and does not arrive at destination in time for delivery the next morning.

THE USE OF MACHINES IN OFFICE WORK

When a Machine May Replace Hand Work—Operation of Posting Machines—Billing and Miscellaneous Machines

The use of machines in office work has increased so greatly in the last few years that a knowledge of the kinds of machines and the nature of the work is a prerequisite for success in bookkeeping and other office work. The various types of office machines and appliances are described on page 504.

When Office Machines Should be Used.—The use of office machines is primarily a question of economy. If it is cheaper to use human rather than machine effort, no machines are necessary. But with the large amount of routine detail necessary in the offices of most large corporations, the use of machines either supplants some employees already on the staff or makes unnecessary the employment of additional workers. Therefore, when an office manager or bookkeeper is faced with the question, "What office machines shall I purchase?" the simplest answer is, "That equipment which costs the least, and yet will satisfactorily do the job." However, there is another rule which is followed by most office men today. It is expected that a machine will pay for itself in one year; at the latest in two years. That means that the economies resulting from the use of the machine will equal the cost of the machine in that time. For example, if the use

CASH RECEIPTS

DISTRICT A MONTH OF MAY 19-- DATE 10 SHEET NO. 1

DATE	INVOICE NO.	DESCRIPTION	DEBIT	CREDIT	BALANCE	PROOF	CUSTOMER'S NAME	DISCOUNT	OTHER DEDUCTIONS	NET CASH	OLD BALANCE	
3		CHECK		123 45	63 25*	186 70	J D JONES	2 47	1 50	119 48*	186 70	

SALES JOURNAL

DISTRICT A MONTH OF MAY 19-- DATE 3 SHEET NO. 1

DATE	INVOICE NO.	DESCRIPTION	DEBIT	CREDIT	BALANCE	PROOF	CUSTOMER'S NAME	OLD BALANCE				
3	321	MDSE	63 25		186 70*	123 45×	J D JONES	123 45				

ACCOUNTS RECEIVABLE LEDGER

CREDIT RATING

NAME J D JONES ACCOUNT NO. 123

CREDIT LIMIT 500

ADDRESS CITY PAGE NO. 5

TERMS

DATE	INVOICE NO.	DESCRIPTION	DEBIT	CREDIT	BALANCE	PROOF
MAY 3 10	321	BRT FWD MDSE CHECK	63 25	123 45	123 45 186 70* 63 25*	123 45× 186 70

STATEMENT

J D JONES
CITY

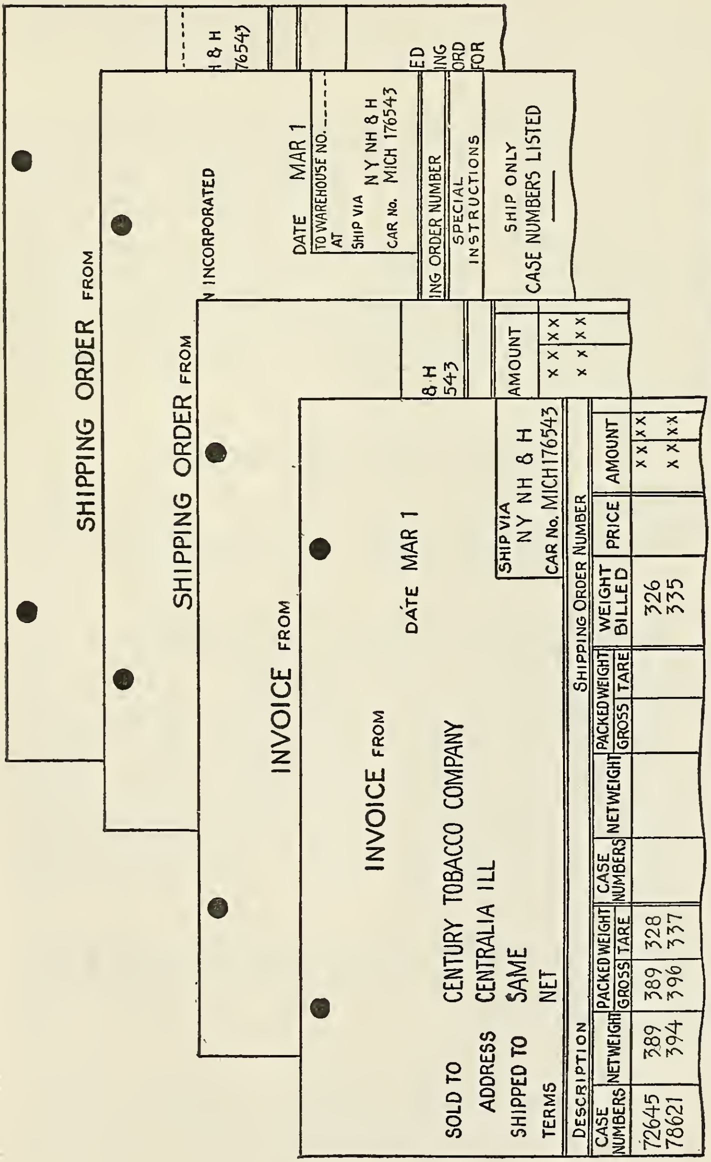
DATE	INVOICE NO.	DESCRIPTION	DEBIT	CREDIT	BALANCE
MAY 3 10	321	BAL FWD MDSE CHECK	63 25	123 45	123 45 186 70* 63 25*

Illustrating Entries on Customer's Statement, Ledger Card, and Sales Journal, or on Customer's Statement, Ledger Card, and Cash Receipts Journal—Made in One Operation of Billing Machine of a billing machine will so increase the output of the billing machine operator that it will be unnecessary to employ a second billing clerk, then the cost of the machine should approximate the salary which a second billing clerk would receive.

Accounting Machines—Posting Machines.—The machines with which the bookkeeper will probably come into contact most frequently, exclusive of typewriter, are the posting machines and billing machines. The posting machines are in great use today in keeping customers' accounts. The number of postings that an operator of such a machine can make in an eight-hour day varies from 600 to 900. The principles on which these machines operate is that of the Boston ledger (see page 270) and the horizontal adding and subtracting machine. When the machine is tabulated into the debit position, the amounts are added to the old balance in the account; if in the credit column, it subtracts the amount from the balance. The final result is printed in the balance column. There are several methods of checking the accuracy of the postings. Usually there is a tape attached to the machine which lists the debits and the credits, so that at the end of the day the bookkeeper merely totals this tape and secures the total debits and credits which will agree with the controlling account. The posting machine is, therefore, an adaptation of the adding machine, with date columns and explanation items added. Sometimes a typewriter is added to the adding mechanism so that a more complete and varied explanation may be written on the ledger card. By the use of carbon paper, or a duplicate mechanical arrangement, many firms find it expedient to prepare the monthly statements simultaneous with the ledger card and at the same time make an exact duplicate of the ledger account. The possibilities of expanding the work of the posting machine are so great that the manufacturers today are able to prepare a sales journal and cash record on the same machine. The illustration appearing on page 500 shows the entries made on the customer's statement, ledger card and sales journal in one operation on such a machine, the entry being a sale made to J. D. Jones for $63.25. Likewise, the illustration shows the entry on the statement, ledger card and cash receipts journal when a payment is made.

Billing Machines.—The billing machine today is an important part of the office machine equipment. Many offices still use the typewriter for the billing work. Others use special billing machines. There are two types of these latter machines. One is the flat bed machine and the other is the cylinder platen type. Billing machines are used to prepare bills, orders, bills of lading, and delivery slips. They are also used to prepare combination records, such as orders and bills and sales book entries. Sometimes a fanfold arrangement is attached to the machine which permits the use of continuous printed forms of bill heads with interleaved carbon paper. This enables the operator to double the output at a slight additional cost in material. The following form shows a combination record of invoice and shipping order prepared in one operation.

Miscellaneous Machines.—Other machines which are common in the bookkeeper's work are cash registers and coin-handling machines, addressing machines and time-recording machines. The cash registers and coin-handling machines are used in receiving cash for cash sales, in making change, or in the preparation of payroll envelopes where the employees are paid in cash. Addressing machines are used to address envelopes and circulars by the use of metal name-and-address plates. These plates are used over and over again. As many as two thousand envelopes can be run off within an hour by means of the addressing machine. The use of this machine has, therefore, been adapted to bookkeeping work in the following instances: to print time tickets,



Illustrating Copies of Invoice and Shipping Order Made in One Operation on Billing Machine the name and number of each employee being put on the name plate; to print job-time tickets for the employees; machine and tool repair records; stock ledger cards; addressing employee pay envelopes, etc.

Closely allied with the addressing machine is the time-recording machine. There are several types on the market—one uses individual cards for each employee; another uses a large sheet in the machine on which each employee is designated by number. The employees punch the cards or tape when they arrive in the morning; when they leave at noon for luncheon; when they return from luncheon; and when they leave at the end of the day.

ACCOUNTING MACHINES

Classification of Accounting Machines—Descriptive Writing and Printing Equipment—Punch Card Method of Tabulation

There is a great difference in efficiency among the various accounting machines, some being better adapted for certain purposes, and others for other purposes. In a great measure the success of applying accounting mechanical methods will depend upon the proper selection and proper application of a machine to a particular accounting condition. In such selection and application, a knowledge of the fundamental characteristics of the various types of machine accounting equipment is essential.

Classification of Machines.—The following is a classification of these accounting machines, based on their fundamental characteristics:

1. Descriptive writing equipment:
   (a) Flat-writing platen and arithmetical features.
   (b) Cylindrical-writing platen and arithmetical features.

2. Printing equipment:
   (a) Flat-printing platen and arithmetical features.
   (b) Cylindrical-printing platen and arithmetical features.
3. Tabulating and Recording Equipment:
   (a) Punch card method.
   (b) Ticket method.

Descriptive Writing Equipment.—This class of machines is applied to work of descriptive writing such as order writing and billing. The two types of machines of this class differ from each other in that the writing surface or platen is flat in the one case and cylindrical in others. Each type has its particular advantages for particular applications. By means of these types of equipment it is possible to write mechanically on cut forms, bound books, and continuous-length forms. The machines have also features making possible vertical and horizontal adding and subtracting.

Printing Equipment.—Modern machines of this class are electrically driven and are designed to meet conditions in accounting and statistics that require various kinds of analysis and distribution data in the process of posting a ledger. The flat-printing platen type posts mechanically, balances ledger accounts automatically, and prints all items in clear, legible type, accumulating totals of all amounts posted. The cylindrical-printing platen type differs mechanically in that the printing surface or place is cylindrical instead of flat.

Tabulating and Recording Equipment.—An analysis of voluminous facts can readily be made from any desired viewpoint with the aid of these electrically driven tabulating and recording machines. They are adaptable to all kinds of analysis or distribution work, such as sales analysis, payroll, cost or expense distribution, purchase analysis, distribution of remittances received, and so on.

There are two distinctive types of this class of machines—the punch card and ticket type. In the punch card method of tabulation, the process consists of three steps:

1. Punching a card with circular holes, the meaning of which depends entirely upon their position on the card.
2. Sorting the punched cards according to the data perforations.
3. Summarizing the information thus sorted under any desirable number of headings.

Machines of the ticket producing type automatically issue tickets on all operations, on any class of applications, or whenever desired. The ticket may be prepared with or without stub, as the operator chooses. The information printed on both parts of the ticket includes the date, serial number, identifying numbers, symbols for the totals used, and the amount. The ticket may be used as a voucher, pay ticket, requisition, posting medium, for filing purposes, and in many other ways.

SOURCES OF CREDIT INFORMATION CONCERNING CUSTOMERS

Firm's Experience with Customer—Statements Submitted by Customer—Salesmen as Source of Credit Information—Mercantile Agencies

The bookkeeper's work is closely allied with that of the firm's credit man. Whenever sales or purchases are made, the question of credit terms is involved. The importance of bookkeeping and accounting records as a basis of credit granting makes it necessary for the bookkeeper to be familiar with certain details of credit information.

Firm's Ledger Experience.—One valuable source of credit information is found in the records of the customers' accounts. The bookkeeper can be of assistance to the credit man and to the firm by noting irregular or delinquent payments, frequent complaints, and merchandise returns, which are almost infallible indications of ultimate loss if the account is continued without attempting to bring about some correction of the account.

Customer's Oral Statements.—A source of information concerning a credit risk is the customer himself. Personal interviews are fruitful sources of such information. They offer many advantages for an insight into the customer's character and behavior. As a result of the interviews, the credit man may or may not be satisfied with the customer's oral statements made by the customer concerning his willingness and ability to pay.

Customers' Written Statements.—It is proper to ask a customer for a written statement of his financial affairs. As credit extensions continue, statements should be obtained from time to time and the customer should respond willingly to such requests. Many concerns buying on credit voluntarily submit periodical financial statements. The statements should be signed by the customers and should include over the signature a declaration that the statement is made for the specific purpose of obtaining credit. Such statements have a definite legal standing in prosecution of the customer for fraud.

Credit Man's Personal Experience with Customer.—Another reliable source of information on credit risks is the credit man's knowledge of individuals and their movements from one concern to another, their fires and failures, or their rise from obscurity to prominence. He should recall that a certain individual, now incorporating a company, as the same man who formerly failed under rather suspicious circumstances; or that another individual who has organized a business is bringing to the new firm the highest type of personal credit standing.

Salesmen as a Source of Credit Information.—Except in retail lines, salesmen usually call on customers and meet them personally. These salesmen are the only representatives of concerns who see many of their customers. Moreover, they meet them more or less frequently. Therefore, salesmen are in a favorable position to become acquainted with the business sagacity and local reputation of customers, and they are, therefore, an important source of credit information.

However, salesmen do not necessarily make good credit or collection men. The art of selling and the business of extending credit are dependent one on the other, but the training of salesmen does not emphasize primarily careful credit granting and effecting collections quickly. Nevertheless, many salesmen do gather useful credit information about customers, and make collections.

Bank Reports.—The bank or banks in which the house has deposits, or the bank given as a reference by a customer, or any bank which the house may have reason to believe can give the desired information, is often called upon for information concerning a customer's credit risk.

Mercantile Agencies.—Of all external sources of credit information, the mercantile agencies are the best known and the most widely used. The foremost of these is Dun & Bradstreet, Inc. (see page following).

Domestic Interchange Bureaus.—The local associations of credit men operate interchange bureaus. Most of these bureaus collaborate with a central office conducted by the National Association of Credit Men, forming a national interchange credit system. The plan of the larger local associations is that all members file with that association a record of their experiences with each of their customers. The members are then supplied with a number of printed forms, one of which is filled out when information is desired on a certain risk. Upon receipt of this inquiry from a member, the association promptly mails an inquiry blank to all other members having dealings with the customers. Replies to these inquires are in turn received by the association, are compiled, and the result sent to the inquiring member. It is customary also to mail a copy of the final report to each member replying to the inquiry first sent out.

Trade Credit Bureaus.—Many trade associations organize sub-departments for the exchange of credit information. The reports of these bureaus have the advantage of specialization in a given industry and with a more or less limited class of debtors.

MERCANTILE AGENCY—DUN & BRADSTREET, INC.

Rating Book on Credit Standing of Concerns Covered—Rating Symbols—Special Reports Furnished by Agency

Rating Book.—Dun & Bradstreet is the best known and most often used of mercantile agencies which disseminate credit information concerning business enterprises. Its organization consists of thousands of trained reporters, correspondents, and attorneys located in every trading center. It publishes a rating book for general reference regarding capital and credit standing of the concerns covered. The book undergoes constant revision and is republished every two months. It purports to list every manufacturer, jobber, wholesaler, retailer, and bank, about 2,000,000 in number. Because of the enormous number of listings, it is necessary to condense the conclusions under two heads, and they are represented by two symbols.

The first symbol used denotes the relative capital or size of the business; and the second indicates the general credit

	Estimated Pecuniary Strength		General Credit			
			High	Good	Fair	Ltd.
*-1	Aa	Over $1,000,000	A1	1	1½	2
	A+	Over $750,000	A1	1	1½	2
	A	500,000 to 750,000	A1	1	1½	2
	B+	300,000 to 500,000	1	1½	2	2½
	B	200,000 to 300,000	1	1½	2	2½
	C+	125,000 to 200,000	1	1½	2	2½
*-2	C	75,000 to 125,000	1½	2	2½	3
	D+	50,000 to 75,000	1½	2	2½	3
	D	35,000 to 50,000	1½	2	2½	3
	E	20,000 to 35,000	2	2½	3	3½
*-3	F	10,000 to 20,000	2½	3	3½	4
	G	5,000 to 10,000		3	3½	4
	H	3,000 to 5,000		3	3½	4
	J	2,000 to 3,000		3	3½	4
*-4	K	1,000 to 2,000		3	3½	4
	L	500 to 1,000			3½	4
	M	Less than 500			3½	4

* When a numeral only (1, 2, 3, or 4) follows a name in the Reference Book, it is an indication that the financial strength, while not definitely determined, is considered within the range of the dollar ($) figures in the corresponding bracket, and that a condition is believed to exist which warrants credit in keeping with that assumption.

The absence of *any* rating following a name signifies circumstances which preclude forming a definite decision as to financial strength or credit standing of the individual or concern named, and should suggest to the Client the advisability of reading the detailed report.

(*d*) Where an italic *d* in parentheses precedes a rating, it is an indication that one or more of the partners in the firm are liable in another or other firms, and the responsibility is in that sense divided, thus: (*d*) B + 2.

Dun & Bradstreet, Inc. Key to Ratings

standing, whether of the best or not so good. The two ratings are distinct and bear no relation to each other. Thus, a large concern may be rated "Aa," meaning that in size it is a $1,000,000 enterprise. The second rating of "1½," however, would indicate that its willingness and ability to pay its debts was not of the best. Again, the first rating of a concern might be "E" indicating $20,000 to $35,000 in size, while its second rating of "2" would signify that its credit standing was high. The table opposite shows the symbols used by Dun & Bradstreet, Inc.

Special Reports.—In addition, Dun & Bradstreet, Inc. furnish reports on the concerns under investigation, which include:

1. History of the past record of the concern or the principals conducting the business.
2. Financial statements showing assets, liabilities, and net worth. These statements are as of current and earlier periods. The agency neither audits nor verifies the statements obtained by it, but requires the signature of the merchant.
3. Comments on general conditions indicated by the statements.
4. Information as to character, habit, and business capacity; and as to location, business outlook, etc. These matters are reported as mere hearsay, but they should not be disregarded unless actually known to be erroneous. Often they will be found to be trustworthy.
5. Information regarding opinions and experiences of other creditors.
6. Fire record.

COLLECTION METHODS

Retaining Customer's Goodwill—Several Steps Open to Collector—Letters and Telegrams—Drafts—Collection Attorneys and Agencies

The aim of the competent collection man of a business establishment is not only to collect but also to retain for his house the goodwill of a good account. To that end he will have as a background all the available credit information as well as the ledger history of the account before he decides upon the mode of handling it.

In trying to collect from the account whose goodwill it is important to retain, as well as from the one requiring more drastic action, several steps are open to the collector.

1. Statements.—Usually the collection process is started by mailing a statement. The first statement is merely a reminder, drawing attention to an oversight or to negligence. This may be followed, if necessary, by other statements bearing comments such as: "Please remit," "Kindly advise if you do not find above amount correct."

2. Letters.—The first letter may be extremely mild and be followed by others of varying degrees of forcefulness but increasing progressively in insistence. Distinctiveness is essential in a letter intended to be attention-compelling. This may be realized by injecting personality into the letter, referring to items in connection with the specific transactions or particular matters of interest to the debtor, and by a proper follow-up course.

3. Telegrams.—The collection telegram suggesting urgency has considerable psychological value. In using it, however, one must avoid liability for libel or extortion. The telegram should not contain a threat of bankruptcy or criminal prosecution.

4. Drafts.—When no satisfactory response is received to collection letters or telegrams, the collector may try to force the issue by drawing on the debtor. Such drafts may be deposited by the collector at his bank, which forwards to a correspondent bank in the debtor's locality, or it may be sent by the creditor direct to the debtor's bank, or to a bank in the debtor's vicinity. Usefulness of the draft as a collection instrument is, however, limited. It usually makes the debtor resentful, or he gives the collecting bank some plausible reason for not paying.

5. Collection Attorneys.—A claim should be placed with an attorney only after careful consideration, since this mode of collection involves expense and the probability of losing the account. Attorneys who specialize in the collection of accounts and who are organized for this service usually can serve to best advantage. Care must be exercised in the selection of such attorneys, so as not to employ an incompetent or unscrupulous attorney.

6. Collection Agencies.—The points to be considered in connection with the attorney apply to the employment of collection agencies for collecting accounts. The good collection agency promptly tries to collect amicably, and advises suit only after the case has been carefully considered.

METHODS OF FINANCIAL STATEMENT ANALYSIS

Aim of Statement Analysis—Component Percentage Method—Ratio Method—Trend Percentage Method

General Purpose of Financial Statement Analysis.—One of the main purposes of accounting work is to prepare and submit the final statements to the business management—the balance sheet showing the financial condition of the company, and the profit and loss statement showing the results of its operations for a given period. In reading or in analyzing and interpreting these financial statements, the purpose is to discern the tendencies that are arising in that business, whether for good or for evil. If such analysis discloses any weaknesses or bad practices in operations, resulting in unduly heavy costs, a remedy may be applied immediately to correct the evil before the loss from it becomes irreparable. On the other hand, if the analysis reveals opportunities for increasing the profits or presenting a more favorable statement, these may be followed up.

Various Types of Analysis.—All methods of financial statement analysis are based on comparison, either between items appearing on statements of the same date, or between corresponding items of statements of different dates, but still of the same company, or with statements of approximately the same date, of other companies engaged in more or less the same line of industry.

The following list includes the principal methods of analysis, with a brief explanation of each.

1. Methods for showing relationship between figures of the same date:

(a) Component percentage method, which consists of reducing each item of the balance sheet to a percentage of the total assets or liabilities, and each item of the income statement to a percentage of sales.

The following balance sheet illustrates this method:

	1934		1935		1936	
ASSETS:	Amount	%	Amount	%	Amount	%
Cash	$ 11,077.81	5	$ 15,645.76	7	$ 9,961.53	5
Receivables	55,697.47	24	38,098.87	17	27,661.28	13
Inventories	49,930.45	21	60,367.29	27	77,826.51	36
Fixed Assets ...	100,579.21	43	95,223.09	43	86,686.72	41
Other Assets ...	15,178.08	7	13,091.68	6	10,995.18	5
	$232,463.02	100	$222,426.69	100	$213,131.22	100
LIABILITIES AND NET WORTH:						
Current Liabilities	$ 16,469.89	7	$ 9,455.41	4	$ 13,693.19	6
Net Worth	215,993.13	93	212,971.28	96	199,438.03	94
	$232,463.02	100	$222,426.69	100	$213,131.22	100

(b) Deviations from standard method, or comparison of the items of the actual statements with the corresponding figures in the estimated balance sheet and income statement of a budget, which represent the goal set by the management for any period taken.

(c) Ratio method, or calculating the ratios or relationships between various items within the balance sheet or within the income statement or between one item of the balance sheet and one of the income statement. These are the familiar financial and operating ratios. Analysis may consist of comparing the actual ratios with those of companies in the same line of business or with standard ratios, established by averaging on some reasonable basis the actual ratios for a number of representative concerns in the same line of industry.

2. Methods of showing changes in the figures in the statement from period to period:

(a) Increase and decrease method, which presents a balance sheet or income statement in comparative form showing the respective increases or decreases for the several items either in amounts or percentages, or both.

The following balance sheet shows the amount increases and decreases:

Assets:	1935	1936	Increase	Decrease
Cash	$ 22,887.68	$ 11,077.81	$	$11,809.87
Receivables	53,252.57	55,697.47	2,444.90	
Inventories	47,524.81	49,930.45	2,405.64	
Fixed Assets	101,484.78	100,579.21		905.57
Other Assets	9,906.30	15,178.02	5,271.78	
	$235,056.14	$232,463.02	$10,122.32	$12,715.44
Liabilities and Net Worth:				
Current Liabilities	$ 20,640.27	$ 16,469.89	$	$ 4,170.38
Net Worth	214,415.87	215,993.13	1,577.26	
	$235,056.14	$232,463.02	$ 1,577.26	$ 4,170.38

(b) Trend percentage method, as developed by Gilman in "Analyzing Financial Statements," by which the trend of the various items of the statements cover a period of years is indicated by means of percentages calculated on the basis of the items for the first year of the period taken, which is considered to be 100%. Thus, an analysis of the trend of the inventory item for four successive years may be represented as 100%, 108%, 125%, 95%, the items for the second, third, and fourth years being figured as percentages of the item for the first year.

This method of analyzing statements is shown by the following balance sheet:

	1935	Trend Per Cent	1936	Trend Per Cent
ASSETS:				
Cash	$ 22,887.68	100%	$ 11,077.81	48%
Receivables	53,252.57	100	55,697.47	105
Inventories	47,524.81	100	49,930.45	105
Fixed Assets	101,484.78	100	100,579.21	99
Other Assets	9,906.30		15,178.08	
	$235,056.14		$232,463.02	
LIABILITIES AND NET WORTH:				
Current Liabilities	$ 20,640.27	100%	$ 16,469.89	80%
Net Worth	214,415.87	100	215,993.13	100
	$235,056.14		$232,463.02	
Sales	$272,787.07	100	$239,313.42	88

FINANCIAL AND OPERATING RATIOS IN STATEMENT ANALYSIS

Eight Important Ratios—"Acid Test" Ratio—Current Assets to Current Liabilities—Turnovers

In analyzing and interpreting financial statements, the following eight ratios are most generally employed:

1. Quick Assets *divided by* Current Liabilities. Quick assets consist of cash and receivables. This is known as the "acid test" ratio, and is of value as a quick index of the debt-paying capacity of the company. Many use a standard of 1 to 1 as a basis of comparison. While this is more or less arbitrary, it has value only if used with discrimination.

2. Current Assets *divided by* Current Liabilities. The difference between this ratio and the "acid test" ratio is the inclusion of inventory with cash and receivables. It is an important difference, however, because of the importance of the inventory item in trading and manufacturing concerns. It has been customary to apply the standard of 2 to 1 to this ratio. Such a standard is, however, a very arbitrary one.

3. Sales *divided by* Receivables. This ratio is frequently referred to as the turnover of receivables and measures the comparative amount of capital invested in the receivables account and the relative efficiency with which collections are made.

4. Sales *divided by* Inventory. This ratio is a useful index of merchandising efficiency—of the purchasing policy in relation to the general sales program.

5. Sales *divided by* Net Worth. On the general theory that sales volume should bear some logical relation to the size of the company as indicated by the net worth, this ratio is often used as one of the tests of insufficient sales.

6. Net Worth *divided by* Fixed Assets. This ratio is employed as one of the tests for overinvestment in fixed assets. A tendency shown by the ratio to decline is an indication of an increasing amount of the company's capital being locked up in the property account.

7. Net Worth *divided by* Current Liabilities. This ratio has value in diagnosing for insufficient capital. From a credit viewpoint a customer with a large net worth and small current liabilities is preferable to one with less net worth and larger current liabilities.

8. Sales *divided by* Fixed Assets. This ratio has value in diagnosing for insufficient sales, or conversely, overinvestment in fixed assets. The larger the sales in comparison with the fixed assets, the greater is the saving in the use of capital.

PUBLIC ACCOUNTING SERVICES

Classification of Services of Public Auditor—Detailed Audit—Test Audit—Other Services

Value of Knowledge of Public Accounting Services.—Nowadays when there is an increasing demand for the services of public accountants by business houses, both large and small, a knowledge of the general nature of those services is a part of the equipment of every skilled bookkeeper. Such knowledge will enable him to cooperate more effectively with the public auditors and make the services of the latter more valuable to his employers.

Classification of Public Accounting Services.—The services rendered by outside auditors are various, but the American Society of Certified Public Accountants and various state societies have indorsed a classification, the principal divisions of which are as follows:

1. Examination of financial condition and detailed audit of transactions for a period. Short title—"Detailed Audit."
2. Examination of financial condition and audit tests of transactions for a period. Short title—"Test Audit."
3. Examination of financial condition and review of operations.
4. Examination of financial condition.
5. Audits of specific accounts.
6. Other services.

Public Auditing Services Explained.—The first two types of services differ only in the degree of thoroughness with which the transactions are verified. In the third and fourth types, the auditor undertakes to substantiate the representations made in respect to the organization under examination, with a view to determining that there is no overstatement of net assets or of net profits, and that the net assets and net profits are at least as good as represented. Such services are not designed to detect dishonesty or fraud or any understatement of assets which may have been concealed in the operating accounts. The fifth division covers either a detailed or test audit of some specific account or group of accounts. The sixth division contains various activities which are considered to fall within the field of the public accountant. Among the services mentioned under this heading are tax services, system installation services, budgetary services, opinions on various questions submitted, and specific investigations.

AUDITING

List of Purposes Served by Audits—Internal and External Auditing—Assisting Public Auditor in His Work

The Purposes of Audit.—Auditing is an analytical process which aims to determine whether certain statements or accounts correctly set forth the results of the business operations for a certain period, or the condition of a business at a certain date. The extent to which such an analysis will be made is determined by the conditions of the business.

Formerly, the primary purpose of an audit was only to detect fraud or errors or to examine the books of a company which was forced into bankruptcy. More recently, the audit has become a recognized part of the business man's operations, which are looked upon much less suspiciously than formerly. The auditor's opinion is recognized as essential in the determination of a business policy.

The purpose of audits may be listed as follows:

1. To ascertain the financial condition and the earnings of a business for the proprietor, partners, stockholders, managers, directors, officers, or bankers and investors in the securities of the corporation.
2. To detect fraud or embezzlement.

3. To detect errors.
4. To secure bank loans on the basis of a statement prepared by a recognized authority disinterested in the business.
5. To inform bondholders periodically that provisions of a deed of trust securing the bonds have been met.
6. To inform partners that the provisions of the partnership arrangement have been met.
7. To assist in the settlement of fire losses.
8. To form the basis of the reorganization of a business concern.
9. To establish the true financial condition in bankrupt and insolvent concerns.
10. To assure stockholders that the accounts presented by the directors are correctly stated.
11. To establish a basis for the fixing of rates by public utilities.
12. To assist in the preparation of all kinds of tax reports.
13. For the moral effect on employees.

Internal versus External Auditing.—Many large organizations maintain an auditing staff whose function it is to audit daily or continuously the accounting records. The internal auditor's work does not eliminate the need of the public accountant's work. It is merely a supplementary internal check on such items as cash, securities, and accounts receivable. Large organizations such as banks and brokerage houses find that it is necessary to do this in order to safeguard their records and property. A thorough and well-organized internal auditing department greatly reduces and facilitates the work of an outside auditing force.

Importance of Auditing to the Employees.—Many office employees feel that the presence of an auditor is a reflection upon their integrity. This is not at all the case. Both internal and external auditing are recognized activities of a business firm especially where the work is greatly subdivided. If the bookkeeper has carefully done his work, there is no concern for worry on the part of the employee. The work of the auditing force is merely to give accurate information to those interested and to protect the honest employee against any suspicions or claims for fraud.

Assisting the Auditor in His Work.—Where an outside auditor is called upon to perform the auditing work, it will be necessary for him to come into more or less close contact with the bookkeeping force. To facilitate the auditor in his work, without too greatly sacrificing the working time of the bookkeeper, the latter should comply with some of the following rules:

1. Be sure that the books are in balance as of the date of closing. Draw up a trial balance of the general ledger with supporting schedules of accounts receivable and accounts payable and any other subsidiary ledgers that may be used.
2. Secure from the bank the latest statement of the bank account. Prepare reconciliation of bank balance.
3. Make all necessary correction and adjusting entries and secure the proper official authorization for each.
4. Promptly submit all books and records for the examination of the auditor when he and his assistants call for them.
5. Answer all necessary questions relating to the books quickly and briefly.
6. Do not linger or stand around watching the auditor's work. Find something else to do in the office unless called by the auditor to answer questions relating to the books.

The bookkeeper should attempt to answer all questions relating to the books. All other questions should be referred to the proper executive.

VERIFYING CURRENT ASSETS

Checking Cash—"Sighting the Notes"—Preparation of Schedule of Accounts Receivable—Aging Accounts—Verifying Inventories and Securities

It is often helpful to the bookkeeper in his work, to be familiar with the essential routine of auditing or verifying the various assets. The following procedure describes the methods used in checking the most important current assets.

Verifying Cash.—The cash in the safe and in the petty cash box is counted. A list is made of the various denominations of the bills, checks, and coins on hand. A certificate or statement is secured from the bank which shows the balances per the bank records on the date of the audit and the present date. The receipts and disbursements are also verified. Since cash is a very easily manipulated asset, it is usually necessary to verify all disbursements and all receipts. Along with this, there should be a voucher for each disbursement. From time to time the auditor finds it necessary to scan the indorsements appearing on the checks to see that they were indorsed by those who were supposed to receive them. The totals of all cash book columns is usually verified.

Verifying Notes Receivable.—It is a simple matter to verify the notes receivable on hand. The notes must actually be examined and the amounts compared with those entered in the Notes Receivable account or in the notes receivable register. This process is known as "sighting the notes." Since it is a simple matter to fill out fictitious notes and to record them in the books, the auditor usually confirms the genuineness of the notes by communicating with the makers. Some notes may have been discounted at the bank and a contingent liability may exist thereon. This fact will usually be brought out in confirming the cash balance at the bank. The bank usually reports, if requested to do so, what notes have been discounted. If the notes are received from others than trade debtors, these should be stated separately.

Verifying Accounts Receivable.—The bookkeeper should facilitate the work of the auditors by preparing a schedule showing the total of the accounts receivable subsidiary ledger. The auditor may then proceed to check each account in detail. However, where there are many accounts this is often a rather laborious task, usually not justified. The auditor, therefore, resorts to a method known as "test check"—that is, he selects certain groups of accounts to verify in detail and, if these are found to be correct, he assumes that the others are also. Sometimes the auditor sends out statements of accounts and requests each customer to report to him directly whether it is correct or not.

It is the duty of the auditor to determine a proper amount to be set up as a Reserve for Bad and Doubtful Accounts. He may do this by "aging the accounts" as described on page 204, or he may have a conference with one or more of the officials of the company and inquire into the probable collectibility of the accounts. Care is usually taken to note whether or not any of the accounts have been assigned or pledged.

Any accounts receivable arising from transactions other than the sale of merchandise are listed under separate headings—such as Due from Officers, Due from Employees, or Due from Affiliated Companies.

When this procedure has all been completed, the auditor is able to set down a correct figure for accounts receivable on the balance sheet. After all, the main purpose of the auditing work is to be sure that the facts on the statements are accurately presented.

Verifying Inventories.—It is not customary to have the auditor prepare or take a physical inventory. This is usually given to him by the owner of a business or one of the officers.

It may have been prepared with the bookkeepers' assistance. The auditor must be careful to verify three phases of the inventory—the quantities, the prices, the extensions and totals. The quantities are sampled—that is, he examines items selected at random—and verifies the quantity. The prices are tested to be sure that the value has not been overstated. With the use of calculating machines today, it is possible to verify all the extensions and totals in a very short time. Some of the precautions that an auditor must take are as follows: that no goods on consignment are included in the inventory; that no supplies or other materials are included in a merchandise inventory; that all goods included in the inventory are salable or usable.

Verifying Securities.—The auditor must be able to examine the securities owned by the firm. If these are in the possession of a bank as a safe depository or in the hands of an attorney, it will be necessary to secure a letter from them confirming the existence and ownership of the securities. It is important to check the names in which the securities are registered or the names appearing on the face of the security. If there are coupon bonds, it is necessary to see that no coupons are missing.

VERIFYING FIXED ASSETS AND CONFIRMING LIABILITIES

Checking Depreciation of Fixed Assets—Intangible Assets—Confirming Liabilities and Capital Stock

Although current assets require very careful attention on the part of the auditor, it is necessary in many instances to verify the other assets and to confirm the liabilities before rendering a reliable report. Some of the common procedures followed are given below.

Fixed Assets.—The auditor usually examines the deeds and other legal evidences of ownership of fixed assets, such as real estate, delivery equipment, and machinery, to be sure that these are really owned by the corporation and are recorded in its name. It is also necessary to examine all future entries in the accounts to note that these are increases in the value of the assets and not merely a means of hiding losses through capitalizing large expenses. Since the government, through its Internal Revenue Department, has clearly indicated what are reasonable rates of depreciation of assets under ordinary usage, it becomes easier for the accountant and auditor to note that a proper amount of depreciation has been set for each asset (see page 331). Patents, goodwill, and copyrights are intangible assets which may cause a little difficulty, but since their relative importance in analyzing a statement is small, confirmation by examining the legal title to these and securing a statement from the proper officials may be sufficient for the simple audit.

Liabilities.—The auditor's main task is not necessarily the checking of the firm's liabilities now on the books. No doubt these are genuine because no concern will add liabilities which it does not owe. But the auditor must be clever enough to attempt to detect whether or not all the liabilities are on the books, or whether those on the books are fully stated. A study of the unpaid vouchers and canceled checks and a cursory examination of the correspondence with some of the largest creditors may prove helpful. The auditor should then separate the liabilities, such as accounts and notes payable, into those arising from trade creditors, and those from officers, employees, and affiliated companies.

Capital Stock.—An examination of the stock records, minute books, and the certificate or articles of incorporation (charter) usually give sufficient information for this verification.

SIMPLE INTEREST CALCULATIONS

Exact and Ordinary Interest—Short-Cut Methods of Calculation—Adjusting Interest Computation from 360-Day to 365-Day Basis

Computing the Days Between Two Dates.—In computing the number of days between two dates, either the first day is included and the last day excluded or the first day is excluded and the last day included. Business and commercial houses as a rule count only the first or last day, but not both.

Example: To find the number of days between July 12 and October 23. Excluding July 12, there are in—

July	19 days
August	31 days
September	30 days
October	23 days
Total	103 days

Brokers and bankers frequently charge interest by counting both the first and last days when the interest is payable to themselves. In the illustration above, there would thus be 104 days between July 12 and October 23.

Exact and Ordinary Interest.—Exact interest is simple interest computed on the basis of 365 days to the year. Ordinary interest, on the other hand, is simple interest computed on the basis of 360 days to the year.

Computation by Formula.—When interest tables are not available, exact interest may be obtained by substituting in the formula, principal × rate × time, the rate per annum in hundredths and the time in years or multiples of a year.

Example: To find the interest on $10,428.40 for 193 days at 4½%.

$$\$10{,}428.40 \times \frac{9}{200} \times \frac{193}{365} = \$248.14$$

Computation by Use of Interest Tables.—By using the 5% exact interest table given on page 531, the exact interest on $8,426.10 for 223 days is found to amount to $257.40.

Short-Cut Calculation of Ordinary Interest at 6%.—The rate of 6% per annum is in more common use than is any other rate. As 6 is a multiple of 12, the number of months in the year, it lends itself to certain mathematical short-cuts. Also, as 30 days per month gives 360 days to the year, this is often used as a basis upon which ordinary interest computations are made. On this basis, the rate per month is ½ of 1%, or 1% for 60 days. Therefore, in order to compute the interest for 60 days on any amount when the rate is 6%, it is only necessary to move the decimal point two places to the left. For example, the interest on $1,580 at 6% for 60 days is $15.80.

If the number of days is a multiple of 6, the solution of any interest problem under this method is simplified, as is shown by the following examples.

Example 1: Find the interest on $847.15 for 108 days at 6%:

	$ 8.4715	interest	for	60	days
	16.9430	"	"	120	"
Less:	1.6943	"	"	12	"
	$15.2487	"	"	108	"

The interest is $15.25

Example 2: Find the interest on $1,430.12 for 83 days at 6%:

$14.3012	interest	for	60	days
4.7671	"	"	20	"
.7151	"	"	3	"
$19.7834	"	"	83	"

The interest is $19.78.

Calculating Interest by Interchange of Principal and Days.—When the principal is a factor or multiple of 6, interchange principal and days. The interest on $4,800 for 27 days is the same as the interest on $27 for 4,800 days. The interest on $27 for 60 days equals $.27, secured by moving the decimal point two places to the left. Multiplying $.27 by 80 gives $21.60, the interest on $27 for 4,800 days, or its equivalent, the interest on $4,800 for 27 days.

Adjusting Interest Computation from 360-Day to 365-Day Basis.—When interest has been computed on the basis of 360 days as in preceding illustrations, and it is desired to adjust it to a 365-day basis, the amount of the interest should be decreased by 1/73 of itself, because the difference of 5 days is 1/73 of 365. Thus, to find the exact interest on $942.52 for 19 days at 6%, take the amount computed on a 360-day basis, $2.98465, and from this amount deduct 1/73 of itself, which leaves $2.94377 as the interest for the given time and rate on a 365-day basis.

Explanation of reason why 1/73 is subtracted from ordinary interest:

1 day's int. on 360-day basis is 1/360 of year's int.
" " " " 365-day " " 1/365 " " "
1 day's exact int.: 1 day's ordinary int. = 1/365 : 1/360
or as 1/73 : 1/72 = 1/73 × 72/1 = 72/73
or, exact int.: Ordinary int. = 72 : 73

Short-Cut Interest Computation at Rates Other Than 6%.—The following additional rules are to be applied when the rate of interest differs from 6%. Point off 2 places of decimals to the left for—

72 days at 5%	90 days at 4%
80 days at 4½%	120 days at 3%

To simplify the labor of determining the number of days between any two dates, the table on page 543 gives the number of days from January 1 to any other day of the year.

Taking the problem just stated and solving it by means of the table, from January 1 to July 12 there are 193 days, and from January 1 to October 23 there are 296 days, or a difference of 103 days. If it is a leap year, there would be 194 days and 297 respectively, or still 103 days.

The number of days were obtained in each instance by dividing 360 by the rate.

Example: To find the interest on $5,186.00 at 5% for 90 days:

	$51.86	interest for 72 days
¼ of $51.86, or	12.97	" " 18 days
	$64.83	" " 90 days at 5%

At 4½% the interest for 90 days would be as follows:

	$51.86	interest for 80 days
⅛ of $51.86, or	6.48	" " 10 days
	$58.34	" " 90 days at 4½%

Where the number of days upon which the interest is to be computed is not a multiple of the days shown in the above tabulation, the following rule is to be applied:

1. Secure the interest for 6 days at 6% by pointing off 3 places in the principal.
2. Multiply this result by the number of days interest is reckoned, which gives interest for six times the required number of days.
3. Divide this result by 6.

Example: To find the interest on $942.52 for 19 days at 6%:

$ .94252	interest for 6 days
19	
848268	
94252	
$17.90788	interest for 114 days

$17.90788 ÷ 6 = $2.98465 interest for 19 days

4% INTEREST TABLE

Exact Interest on 365-Day Basis at 4%, by Days from 1 to 360 Days

Da.	$1,000	$2,000	$3,000	$4,000	$5,000	$6,000	$7,000	$8,000	$9,000
1	.1096	.2192	.3288	.4384	.5479	.6575	.7671	.8767	.9863
2	.2192	.4384	.6575	.8767	1.0959	1.3151	1.5342	1.7534	1.9726
3	.3288	.6575	.9863	1.3151	1.6438	1.9726	2.3014	2.6301	2.9589
4	.4384	.8767	1.3151	1.7534	2.1918	2.6301	3.0685	3.5068	3.9452
5	.5479	1.0959	1.6438	2.1918	2.7397	3.2877	3.8356	4.3836	4.9315
6	.6575	1.3151	1.9726	2.6301	3.2877	3.9452	4.6027	5.2603	5.9178
7	.7671	1.5342	2.3014	3.0685	3.8356	4.6027	5.3699	6.1370	6.9041
8	.8767	1.7534	2.6301	3.5068	4.3836	5.2603	6.1370	7.0137	7.8904
9	.9863	1.9726	2.9589	3.9452	4.9315	5.9178	6.9041	7.8904	8.8767
10	1.0959	2.1918	3.2877	4.3836	5.4795	6.5753	7.6712	8.7671	9.8630
20	2.1918	4.3836	6.5753	8.7671	10.9589	13.1507	15.3425	17.5342	19.7260
30	3.2877	6.5753	9.8630	13.1507	16.4384	19.7260	23.0137	26.3014	29.5890
40	4.3836	8.7671	13.1507	17.5342	21.9178	26.3014	30.6849	35.0685	39.4521
50	5.4795	10.9589	16.4384	21.9178	27.3973	32.8767	38.3562	43.8356	49.3151
60	6.5753	13.1507	19.7260	26.3014	32.8767	39.4521	46.0274	52.6027	59.1781
70	7.6712	15.3425	23.0137	30.6849	38.3562	46.0274	53.6986	61.3699	69.0411
80	8.7671	17.5342	26.3014	35.0685	43.8356	52.6027	61.3699	70.1370	78.9041
90	9.8630	19.7260	29.5890	39.4521	49.3151	59.1781	69.0411	78.9041	88.7671
100	10.9589	21.9178	32.8767	43.8356	54.7945	65.7534	76.7123	87.6712	98.6301
110	12.0548	24.1096	36.1644	48.2192	60.2740	72.3288	84.3836	96.4384	108.4932
120	13.1507	26.3014	39.4521	52.6027	65.7534	78.9041	92.0548	105.2055	118.3562
130	14.2466	28.4932	42.7397	56.9863	71.2329	85.4795	99.7260	113.9726	128.2192
140	15.3425	30.6849	46.0274	61.3699	76.7123	92.0548	107.3973	122.7397	138.0822
150	16.4384	32.8767	49.3151	65.7534	82.1918	98.6301	115.0685	131.5068	147.9452
160	17.5342	35.0685	52.6027	70.1370	87.6712	105.2055	122.7397	140.2740	157.8082
170	18.6301	37.2603	55.8904	74.5205	93.1507	111.7808	130.4110	149.0411	167.6712
180	19.7260	39.4521	59.1781	78.9041	98.6301	118.3562	138.0822	157.8082	177.5342
190	20.8219	41.6438	62.4658	83.2877	104.1096	124.9315	145.7534	166.5753	187.3973
200	21.9178	43.8356	65.7534	87.6712	109.5890	131.5068	153.4247	175.3425	197.2603
210	23.0137	46.0274	69.0411	92.0548	115.0685	138.0822	161.0959	184.1096	207.1233
220	24.1096	48.2192	72.3288	96.4384	120.5479	144.6575	168.7671	192.8767	216.9863
230	25.2055	50.4110	75.6164	100.8219	126.0274	151.2329	176.4384	201.6438	226.8493
240	26.3014	52.6027	78.9041	105.2055	131.5068	157.8082	184.1096	210.4110	236.7123
250	27.3973	54.7945	82.1918	109.5890	136.9863	164.3836	191.7808	219.1781	246.5753
260	28.4932	56.9863	85.4795	113.9726	142.4658	170.9589	199.4521	227.9452	256.4384
270	29.5890	59.1781	88.7671	118.3562	147.9452	177.5342	207.1233	236.7123	266.3014
280	30.6849	61.3699	92.0548	122.7397	153.4247	184.1096	214.7945	245.4795	276.1644
290	31.7808	63.5616	95.3425	127.1233	158.9041	190.6849	222.4658	254.2466	286.0274
300	32.8767	65.7534	98.6301	131.5068	164.3836	197.2603	230.1370	263.0137	295.8904
310	33.9726	67.9452	101.9178	135.8904	169.8630	203.8356	237.8082	271.7808	305.7534
320	35.0685	70.1370	105.2055	140.2740	175.3425	210.4110	245.4795	280.5479	315.6164
330	36.1644	72.3288	108.4932	144.6575	180.8219	216.9863	253.1507	289.3151	325.4795
340	37.2603	74.5205	111.7808	149.0411	186.3014	223.5616	260.8219	298.0822	335.3425
350	38.3562	76.7123	115.0685	153.4247	191.7808	230.1370	268.4932	306.8493	345.2055
360	39.4521	78.9041	118.3562	157.8082	197 2603	236.7123	276.1644	315.6164	355.0685

5% INTEREST TABLE

Exact Interest on 365-Day Basis at 5%, by Days from 1 to 360 Days

Da.	$1,000	$2,000	$3,000	$4,000	$5,000	$6,000	$7,000	$8,000	$9,000
1	.1370	.2740	.4110	.5749	.6849	.8219	.9589	1.0959	1.2329
2	.2740	.5479	.8219	1.0959	1.3699	1.6438	1.9178	2.1918	2.4658
3	.4110	.8219	1.2329	1.6438	2.0548	2.4657	2.8767	3.2877	3.6986
4	.5479	1.0959	1.6438	2.1918	2.7397	3.2877	3.8356	4.3836	4.9315
5	.6849	1.3699	2.0548	2.7397	3.4247	4.1096	4.7945	5.4795	6.1644
6	.8219	1.6438	2.4658	3.2877	4.1096	4.9315	5.7534	6.5753	7.3973
7	.9589	1.9178	2.8767	3.8356	4.7945	5.7534	6.7123	7.6712	8.6301
8	1.0959	2.1918	3.2877	4.3836	5.4795	6.5753	7.6712	8.7671	9.8630
9	1.2329	2.4658	3.6986	4.9315	6.1644	7.3973	8.6301	9.8630	11.0959
10	1.3699	2.7397	4.1096	5.4795	6.8493	8.2192	9.5890	10.9589	12.3288
20	2.7397	5.4795	8.2192	10.9589	13.6986	16.4384	19.1781	21.9178	24.6575
30	4.1096	8.2192	12.3288	16.4384	20.5479	24.6575	28.7671	32.8767	36.9863
40	5.4795	10.9589	16.4384	21.9178	27.3973	32.8767	38.3562	43.8356	49.3151
50	6.8493	13.6986	20.5479	27.3973	34.2466	41.0959	47.9452	54.7945	61.6438
60	8.2192	16.4384	24.6575	32.8767	41.0959	49.3151	57.5342	65.7534	73.9726
70	9.5890	19.1781	28.7671	38.3562	47.9452	57.5342	67.1233	76.7123	86.3014
80	10.9589	21.9178	32.8767	43.8356	54.7945	65.7334	76.7123	87.6712	98.6301
90	12.3288	24.6575	36.9863	49.3151	61.6438	73.9726	86.3014	98.6301	110.9589
100	13.6986	27.3973	41.0959	54.7945	68.4931	82.1918	95.8904	109.5890	123.2877
110	15.0685	30.1370	45.2055	60.2740	75.3425	90.4110	105.4795	120.5479	135.6164
120	16.4384	32.8767	49.3151	65.7534	82.1918	98.6301	115.0685	131.5068	147.9452
130	17.8082	35.6164	53.4247	71.2329	89.0411	106.8493	124.6575	142.4658	160.2740
140	19.1781	38.3562	57.5342	76.7123	95.8904	115.0685	134.2466	153.4247	172.6027
150	20.5479	41.0959	61.6438	82.1918	102.7397	123.2877	143.8356	164.3836	184.9315
160	21.9178	43.8356	65.7534	87.6712	109.5890	131.5068	153.4247	175.3425	197.2603
170	23.2877	46.5753	69.8630	93.1507	116.4384	139.7260	163.0137	186.3014	209.5890
180	24.6575	49.3151	73.9726	98.6301	123.2877	147.9452	172.6027	197.2603	221.9178
190	26.0274	52.0548	78.0822	104.1096	130.1370	156.1644	182.1918	208.2192	234.2466
200	27.3973	54.7945	82.1918	109.5890	136.9863	164.3836	191.7808	219.1781	246.5753
210	28.7671	57.5342	86.3014	115.0685	143.8356	172.6027	201.3699	230.1370	258.9041
220	30.1370	60.2740	90.4110	120.5479	150.6849	180.8219	210.9589	241.0959	271.2329
230	31.5068	63.0137	94.5205	126.0274	157.5342	189.0411	220.5479	252.0548	283.5616
240	32.8767	65.7534	98.6301	131.5068	164.3836	197.2603	230.1370	263.0137	295.8904
250	34.2466	68.4932	102.7397	136.9863	171.2329	205.4795	239.7260	273.9726	308.2192
260	35.6164	71.2329	106.8493	142.4658	178.0822	213.6986	249.3151	284.9315	320.5479
270	36.9863	73.9726	110.9589	147.9452	184.9315	221.9178	258.9041	295.8904	332.8767
280	38.3562	76.7123	115.0685	153.4247	191.7808	230.1370	268.4932	306.8493	345.2055
290	39.7260	79.4521	119.1781	158.9041	198.6301	238.3562	278.0822	317.8082	357.5342
300	41.0959	82.1918	123.2877	164.3836	205.4795	246.5753	287.6712	328.7671	369.8630
310	42.4658	84.9315	127.3973	169.8630	212.3288	254.7945	297.2603	339.7260	382.1918
320	43.8356	87.6712	131.5068	175.3425	219.1781	263.0137	306.8493	350.6849	394.5205
330	45.2055	90.4110	135.6164	180.8219	226.0274	271.2329	316.4384	361.6438	406.8493
340	46.5753	93.1507	139.7260	186.3014	232.8767	279.4521	326.0274	372.6027	419.1781
350	47.9452	95.8904	143.8356	191.7808	239.7260	287.6712	335.6164	383.5616	431.5068
360	49.3151	98.6301	147.9452	197.2603	246.5753	295.8904	345.2055	394.5205	443.8356

6% INTEREST TABLE

Exact Interest on 365-Day Basis at 6%, by Days from 1 to 360 Days

Da.	$1,000	$2,000	$3,000	$4,000	$5,000	$6,000	$7,000	$8,000	$9,000
1	.1644	.3288	.4932	.6575	.8219	.9863	1.1507	1.3151	1.4795
2	.3288	.6575	.9863	1.3151	1.6438	1.9726	2.3014	2.6301	2.9589
3	.4932	.9863	1.4795	1.9726	2.4658	2.9589	3.4521	3.9452	4.4384
4	.6575	1.3151	1.9726	2.6301	3.2877	3.9452	4.6027	5.2603	5.9178
5	.8219	1.6438	2.4658	3.2877	4.1096	4.9315	5.7534	6.5753	7.3973
6	.9863	1.9726	2.9589	3.9452	4.9315	5.9178	6.9041	7.8904	8.8767
7	1.1507	2.3014	3.4521	4.6027	5.7534	6.9041	8.0548	9.2055	10.3562
8	1.3151	2.6301	3.9452	5.2603	6.5753	7.8904	9.2055	10.5205	11.8356
9	1.4795	2.9589	4.4384	5.9178	7.3973	8.8767	10.3562	11.8356	13.3151
10	1.6438	3.2877	4.9315	6.5753	8.2192	9.8630	11.5068	13.1507	14.7945
20	3.2877	6.5753	9.8630	13.1507	16.4384	19.7260	23.0137	26.3014	29.5890
30	4.9315	9.8630	14.7945	19.7260	24.6575	29.5890	34.5205	39.4521	44.3836
40	6.5753	13.1507	19.7260	26.3014	32.8767	39.4521	46.0274	52.6027	59.1781
50	8.2192	16.4384	24.6575	32.8767	41.0959	49.3151	57.5342	65.7534	73.9726
60	9.8630	19.7260	29.5890	39.4521	49.3151	59.1781	69.0411	78.9041	88.7671
70	11.5068	23.0137	34.5205	46.0274	57.5342	69.0411	80.5479	92.0548	103.5616
80	13.1507	26.3014	39.4521	52.6027	65.7534	78.9041	92.0548	105.2055	118.3562
90	14.7945	29.5890	44.3836	59.1781	73.9726	88.7671	103.5616	118.3562	133.1507
100	16.4384	32.8767	49.3151	65.7534	82.1918	98.6301	115.0685	131.5068	147.9452
110	18.0822	36.1644	54.2466	72.3288	90.4110	108.4932	126.5753	144.6575	162.7397
120	19.7260	39.4521	59.1781	78.9041	98.6301	118.3562	138.0822	157.8082	177.5342
130	21.3699	42.7397	64.1096	85.4795	106.8493	128.2192	149.5890	170.9589	192.3288
140	23.0137	46.0274	69.0411	92.0548	115.0685	138.0822	161.0959	184.1096	207.1233
150	24.6575	49.3151	73.9726	98.6301	123.2877	147.9452	172.6027	197.2603	221.9178
160	26.3014	52.6027	78.9041	105.2055	131.5068	157.8082	184.1096	210.4110	236.7123
170	27.9452	55.8904	83.8356	111.7808	139.7260	167.6712	195.6164	223.5616	251.5068
180	29.5890	59.1781	88.7671	118.3562	147.9452	177.5342	207.1233	236.7123	266.3014
190	31.2329	62.4658	93.6986	124.9315	156.1644	187.3973	218.6301	249.8630	281.0959
200	32.8767	65.7534	98.6301	131.5068	164.3836	197.2603	230.1370	263.0137	295.8904
210	34.5205	69.0411	103.5616	138.0822	172.6027	207.1233	241.6438	276.1644	310.6849
220	36.1644	72.3288	108.4932	144.6575	180.8219	216.9863	253.1507	289.3151	325.4795
230	37.8082	75.6164	113.4247	151.2329	189.0411	226.8493	264.6575	302.4658	340.2740
240	39.4521	78.9041	118.3562	157.8082	197.2603	236.7123	276.1644	315.6164	355.0685
250	41.0959	82.1918	123.2877	164.3836	205.4795	246.5753	287.6712	328.7671	369.8630
260	42.7397	85.4795	128.2192	170.9589	213.6986	256.4384	299.1781	341.9178	384.6575
270	44.3836	88.7671	133.1507	177.5342	221.9178	266.3014	310.6849	355.0685	399.4521
280	46.0274	92.0548	138.0822	184.1096	230.1370	276.1644	322.1918	368.2192	414.2466
290	47.6712	95.3425	143.0137	190.6849	238.3562	286.0274	333.6986	381.3699	429.0411
300	49.3151	98.6301	147.9452	197.2603	246.5753	295.8904	345.2055	394.5205	443.8356
310	50.9589	101.9178	152.8767	203.8356	254.7945	305.7534	356.7123	407.6712	458.6301
320	52.6027	105.2055	157.8082	210.4110	263.0137	315.6164	368.2192	420.8219	473.4247
330	54.2466	108.4932	162.7397	216.9863	271.2329	325.4795	379.7260	433.9726	488.2192
340	55.8904	111.7808	167.6712	223.5616	279.4521	335.3425	391.2329	447.1233	503.0137
350	57.5342	115.0685	172.6027	230.1370	287.6712	345.2055	402.7397	460.2740	517.8082
360	59.1781	118.3562	177.5342	236.7123	295.8904	355.0685	414.2466	473.4247	532.6027

With a rate other than 6%, find the interest at 6% as on page 529 and adjust the interest to the required basis. For example, with a rate of 5%, the interest on $942.52 for 19 days is $2.48721. This would be found by taking 5/6 of the interest at 6% which was $2.98465.

With a rate of 7%, take 7/6 of the interest at 6%, which gives $3.48209.

RATIO AND PROPORTION

Ratio and Proportion Defined—Finding Missing Term of a Proportion—Practical Applications

Ratio Defined.—The ratio of one number to another is the fraction of which the one number is the numerator and the other the denominator. The ratio is expressed either as a fraction, as 2/3, or by placing a colon between the numbers, as 2:3.

Proportion.—When two ratios are equal, they form a proportion. For example, $2:3 = 8:12$. The first and the last terms, 2 and 12, are called extremes. The second and third terms are called the means. Given any three terms of a proportion, the fourth can readily be found. If the missing term is an extreme, multiply together the two means and divide by the extreme given. If the missing term is a mean, multiply together the two extremes and divide by the mean given.

The rule for dividing a number in proportion to a given series of numbers, is to divide the number by the sum of the numbers in the series and then multiply the quotient by each number of the series.

Practical Applications.—Practical applications of ratios and proportions are frequently found in business. One of the most common is in the distribution of net profits among partners.

Example: A partnership has net earnings for the year amounting to $136,500 which is to be distributed among the three partners in the ratio of 2, 3, 8.

The sum of this series is 13.
Dividing $136,500 by 13 gives $10,500.
Multiplying by the numbers in the series the distribution of profit is as follows:

2 × 10,500 =	$ 21,000
3 × 10,500 =	31,500
8 × 10,500 =	84,000
Total.....	$136,500

RULES FOR COMPUTING INTEREST ON PARTIAL PAYMENTS

Merchant's Rule and United States Rule—Practical Application of Rules Illustrated

When a short-term debt is paid in periodical instalments, the interest upon the indebtedness is computed in either one of two ways. The method commonly used among business men is known as the "Merchant's Rule." This method gives the results more quickly but not as accurately as the other method, the "United States Rule," so called because of its approval by the United States Supreme Court.

"Merchant's Rule."—In following the "Merchant's Rule," the interest is computed upon the total debt from the date of its creation to the date of maturity, and the interest earned from the date each partial payment is made to the date of maturity of the debt is deducted therefrom.

Example: A merchant obligates himself to liquidate a debt of $7,500 incurred January 1 and due on June 1 with interest at 6% per annum by making the following payments: $2,500 on February 1, $2,500 on March 15, $1,500 on May 1, and the balance on June 1.

Original debt		$7,500.00
Interest on $7,500 for 5 months		$ 187.50
Less:		
Interest on $2,500 for 4 months	$50.00	
Interest on 2,500 for 2½ months	31.25	
Interest on 1,500 for 1 month	7.50	88.75
Interest due June 1		98.75
Unpaid principal		1,000.00
Balance due June 1		$1,098.75

"United States Rule."—Under the "United States Rule," each instalment is first applied against the interest due at the date the partial payment is made, and the balance of the instalment is then applied to reduce the principal. Interest is always computed upon the reduced principal, as shown below:

Original debt		$7,500.00
Payment made February 1	$2,500.00	
Interest on $7,500 for 1 month	37.50	2,462.50
		5,037.50
Payment made March 15	2,500.00	
Interest on $5,037.50 for 1½ months	37.78	2,462.22
		2,575.28
Payment made May 1	1,500.00	
Interest on $2,575.28 for 1½ months	19.31	1,480.69
		1,094.59
Interest on $1,094.59 for 1 month to June 1		5.47
Balance due June 1		$1,100.06

However, in case any payment is not large enough to pay the interest on the principal up to the date of such payment, then this payment is held by the creditor, without reduction of principal, until this payment and subsequent payments exceed the accrued interest.

WEIGHTS AND MEASURES—UNITED STATES

TROY WEIGHT

24 grains = 1 pennyweight
20 pennyweights = 1 ounce
12 ounces = 1 pound

APOTHECARIES' WEIGHT

20 grains = 1 scruple
3 scruples = 1 dram
8 drams = 1 ounce
12 ounces = 1 pound

The ounce and the pound in this system are the same as in troy weight.

AVOIRDUPOIS WEIGHT

$27\frac{11}{32}$ grains = 1 dram
16 drams = 1 ounce
16 ounces = 1 pound
25 pounds = 1 quarter
4 quarters = 1 hundredweight
2,000 pounds = 1 short ton
2,240 pounds = 1 long ton

DRY MEASURE

2 pints = 1 quart
8 quarts = 1 peck
4 pecks = 1 bushel
36 bushels = 1 chaldron

LIQUID MEASURE

4 gills = 1 pint
2 pints = 1 quart
4 quarts = 1 gallon
31½ gallons = 1 barrel
2 barrels = 1 hogshead
16 fluid ounces = 1 pint

TIME MEASURE

60 seconds = 1 minute
60 minutes = 1 hour
24 hours = 1 day
7 days = 1 week
28, 29, 30, or 31 days = 1 calendar month
365 days = 1 year
366 days = 1 leap year

LONG MEASURE

12 inches = 1 foot
3 feet = 1 yard
5½ yards = 1 rod
40 rods = 1 furlong
8 furlongs = 1 standard mile
3 miles = 1 league

CLOTH MEASURE

2¼ inches = 1 nail
4 nails = 1 quarter
4 quarters = 1 yard

SQUARE MEASURE

144 square inches = 1 square foot
9 square feet = 1 square yard
30¼ square yards = 1 square rod
40 square rods = 1 rood
4 roods = 1 acre
640 acres = 1 square mile

SURVEYORS' MEASURE

7.92 inches = 1 link
25 links = 1 rod
10 square chains or 160 square rods = 1 acre
640 acres = 1 square mile
36 square miles (6 miles square) = 1 township
4 rods = 1 chain

CUBIC MEASURE

1,728 cubic inches = 1 cubic foot
27 cubic feet = 1 cubic yard
2,150.42 cubic inches = 1 standard bushel
231 cubic inches = 1 standard gallon (liquid)
1 cubic foot = 4/5 of a bushel
128 cubic feet = 1 cord (wood)
40 cubic feet = 1 ton (shipping)

LEGAL AND LAWFUL RATES OF INTEREST

State	Legal Rate of Interest	Maximum Rate Permitted by Agreement
Alabama	6%	8%
Arizona	6	10
Arkansas	6	10
California	7	12
Colorado	8	12 On amounts to $300 and any agreed rate above this amount
Connecticut	6	12
Delaware	6	6
District of Columbia	6	8
Florida	8	10
Georgia	7	8
Idaho	7	10
Illinois	5	7
Indiana	6	8
Iowa	6	8
Kansas	6	10
Kentucky	6	6
Louisiana	5	8
Maine	6	Any rate parties may agree to
Maryland	6	6
Massachusetts	6	Any rate parties may agree to
Michigan	5	7
Minnesota	6	8
Mississippi	6	8
Missouri	6	8
Montana	8	10
Nebraska	7	10
Nevada	7	12
New Hampshire	6	Any rate parties may agree to
New Jersey	6	6
New Mexico	6	12 On unsecured loans 10 On secured loans
New York	6	6 No restriction on demand loans above $5,000 secured by collateral
North Carolina	6	6
North Dakota	6	9
Ohio	6	8
Oklahoma	6	10
Oregon	6	10
Pennsylvania	6	6
Rhode Island	6	30
South Carolina	7	8
South Dakota	7	10
Tennessee	6	6
Texas	6	10
Utah	8	12
Vermont	6	6
Virginia	6	6
Washington	6	12
West Virginia	6	6
Wisconsin	6	10
Wyoming	7	10

The legal rate of interest is the rate of interest fixed by law in each state for application where no rate has been stipulated by the parties to an agreement, and in the award of damages, including interest, by a court of law. Any rate of interest which may be charged in agreements up to the maximum set by law is a lawful rate. Charging interest in excess of the maximum rate is usury and unlawful.

AVERAGING ONE-SIDED ACCOUNTS

Settlement of One-Sided Account—Finding Equated Date—Making Adjustment for Interest

General Procedure.—Sometimes it is desired to settle by a single payment an account consisting of several items due on different dates—some overdue and some not as yet due. The question then arises what the amount should be, given the date of settlement. This is determined with the aid of a process called averaging accounts, consisting of the following two steps:

First, find the date on which settlement may be made simply by payment of the amount of the account balance as shown on the books. This will be the so-called equated due date, or the date on which interest on the overdue items exactly balances interest on the items not as yet due.

Second, if the actual date chosen for the settlement is before the equated date, interest should be deducted from the account balance in making payment; if the date of settlement is after the equated date, interest should be added to the account balance.

Settlement of One-Sided Accounts.—A one-sided account is one which on the creditor's book has only debit items and, vice versa, on the debtor's books has only credit items. Assume the following account on the books of the creditor:

Dr.		J. Jones		Cr.		
19—						
Feb.	10	Mdse 60 da.	600 –			
"	18	" 30 "	1,550 –			
Mar.	9	" 60 "	920 –			

The balance of the account is $3,070, and the due dates of the three items in the account are April 11, March 20, and May 8, respectively. Suppose it is desired to make a settlement of the account on April 13. It is then necessary to decide whether a payment of $3,070 would make an equitable settlement, or whether the debtor should pay an additional sum for interest and how much, or be allowed a certain sum for interest and how much.

Finding the Equated Date.—The first step is to find the equated date of the account. This is done by compiling the following table:

Due Dates of Items	Days from Focal Date	Amount of Item	Product Dollars × Days
April 11	22	$ 600	13,200
March 20	0	1,550	0
May 8	49	920	45,280
		$3,070	58,480

By reference to this table the steps taken in arriving at the equated date may be stated as follows:

1. Find the due date of each item, as shown in the first column of the above table.
2. Take any convenient date as an assumed date of settlement. This is known as the focal date. It is usually advantageous to use the earliest due date as the focal date. In the above example it is March 20.
3. Compute the number of days each due date is beyond the focal date. This is shown in the second column of the table.

4. Multiply, in the case of each item, its amount by the number of days its due date is beyond the focal date, and add the products. This gives a sum of $58,480, as set forth in the last column of the table.
5. Divide this sum by the total balance of the account thus:

$$\frac{58,480}{3,070} = 19.05 \text{ or } 19$$

6. The result is the number of days the equated date is beyond the focal date. As the focal date is March 20, the equated date is therefore April 8.

Accordingly, on April 8, the entire account may be settled by a payment of $3,070, the amount of the account, without any adjustment for interest.

Adjustment for Interest.—While April 8, the equated date, is the date on which the account can be settled by its amount without any adjustment for interest, the actual date of settlement may be after or before that date. If it is April 13, then 5 days' interest should be added to the amount. If the bill is paid on April 4, 4 days' interest should be deducted from the amount.

AVERAGING COMPOUND ACCOUNTS

Equated Date Later Than Focal Date—Earlier Than Focal Date —When Account Contains Notes

Compound accounts contain both debit and credit items. However, the general principle of averaging the account and finding the amount due on whatever day settlement is made is the same as in the case of the one-sided account (see page 538).

Equated Date Later Than Focal Date.—Find the equated date of the following account:

Dr.		J. Jones					Cr.
19—				19—			
June	15	Mdse. 60 da.	400 –	July	3	Cash	200 –
"	25	" 30 "	1,200 –	"	26	"	600 –

The earliest due date is in effect July 3, as that is when the first cash payment was made by the debtor. This is, therefore, the focal date. The number of days the equated date is beyond this focal date is computed according to the following table:

Due Date	Days from Focal Date	Amount of Item	Product (Dollars × Days)	Due Date	Days from Focal Date	Amount of Item	Product (Dollars × Days)
Aug. 14	42	$ 400	16,800	July 3	0	$200	0
July 25	22	1,200	26,400	" 26	23	600	13,800
Aug. 7	35	800	28,000				
		2,400	71,200			$800	13,800
	Less Cr.	800	13,800				
		$1,600	57,400				

X = 35.9 = 36 days practically from focal date.

The number of days the equated date is beyond the focal date, July 3, is, therefore,

$$\frac{57{,}400}{1{,}600} = 35.9 \text{ or } 36 \text{ days}$$

Hence, the equated date, or the date on which settlement of the account may be made without any interest adjustment, is August 8.

Note that in averaging a compound account, each side is dealt with at first as though it were a one-sided account. Then the balances are found of the total dollar amounts and of the dollar-days. The dollar balance is divided into the dollar-day balance to find the number of days the equated date is from the focal date. Because the balances are found in this instance on the same side of the account, the rule in that case is that the equated date is after the focal date.

Equated Date Before Focal Date.—If the balance of dollars and dollar-day products fall on opposite sides of the account, the answer obtained by dividing the one into the other represents the number of days before the focal date the account is equitably due, as in the following account:

Dr. J. JONES Cr.

19—					19—			
June	15	Mdse. 60 da.		400 –	July	3	Cash	200 –
"	25	" 30 "		1,200 –	Aug.	26	"	1,600 –
July	8	" 30 "		800 –				

As the earliest due date in this example is July 3, this is the focal date. The equated date is, therefore, found as follows:

Due Date	Days from Focal Date	Amount of Item	Product (Dollars × Days)	Due Date	Days from Focal Date	Amount of Item	Product (Dollars × Days)
Aug. 14	42	$ 400	16,800	July 3	0	$ 200	0
July 25	22	1,200	26,400	Aug. 26	54	1,600	86,400
Aug. 7	35	800	28,000				
		2,400	71,200			$1,800	86,400
	Less Cr.	1,800			Less Dr.		71,200
	Balance	$ 600				Balance	15,200

The number of days the equated date is from the focal date is:

$$\frac{15{,}200}{600} = 25.3 \text{ or } 25 \text{ days}$$

As the dollar and dollar-day balances are on opposite sides of the account, the equated date is 25 days before the focal date of July 3, or June 8. If Jones should settle the account after this date, he would pay interest for that number of days.

Account Containing Notes.—When notes are included in the account, they are treated as follows:

1. If interest-bearing, they are dealt with exactly like cash; that is, they are considered as a payment as of the date received.
2. If non-interest-bearing, they are considered as payment as of date of maturity.

THE NUMBER OF EACH DAY OF THE YEAR

Counting from January 1

Day of Month	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
1	1	32	60	91	121	152	182	213	244	274	305	335
2	2	33	61	92	122	153	183	214	245	275	306	336
3	3	34	62	93	123	154	184	215	246	276	307	337
4	4	35	63	94	124	155	185	216	247	277	308	338
5	5	36	64	95	125	156	186	217	248	278	309	339
6	6	37	65	96	126	157	187	218	249	279	310	340
7	7	38	66	97	127	158	188	219	250	280	311	341
8	8	39	67	98	128	159	189	220	251	281	312	342
9	9	40	68	99	129	160	190	221	252	282	313	343
10	10	41	69	100	130	161	191	222	253	283	314	344
11	11	42	70	101	131	162	192	223	254	284	315	345
12	12	43	71	102	132	163	193	224	255	285	316	346
13	13	44	72	103	133	164	194	225	256	286	317	347
14	14	45	73	104	134	165	195	226	257	287	318	348
15	15	46	74	105	135	166	196	227	258	288	319	349
16	16	47	75	106	136	167	197	228	259	289	320	350
17	17	48	76	107	137	168	198	229	260	290	321	351
18	18	49	77	108	138	169	199	230	261	291	322	352
19	19	50	78	109	139	170	200	231	262	292	323	353
20	20	51	79	110	140	171	201	232	263	293	324	354
21	21	52	80	111	141	172	202	233	264	294	325	355
22	22	53	81	112	142	173	203	234	265	295	326	356
23	23	54	82	113	143	174	204	235	266	296	327	357
24	24	55	83	114	144	175	205	236	267	297	328	358
25	25	56	84	115	145	176	206	237	268	298	329	359
26	26	57	85	116	146	177	207	238	269	299	330	360
27	27	58	86	117	147	178	208	239	270	300	331	361
28	28	59	87	118	148	179	209	240	271	301	332	362
29	29		88	119	149	180	210	241	272	302	333	363
30	30		89	120	150	181	211	242	273	303	334	364
31	31		90		151		212	243		304		365

NOTE.—For leap years the number of the day is one greater than the tabular number after February 28.

NUMBER OF DAYS BETWEEN MONTHS

From Any Day of	To the Same Day of the Next											
	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Jan.	365	31	59	90	120	151	181	212	243	273	304	334
Feb.	334	365	28	59	89	120	150	181	212	242	273	303
Mar.	306	337	365	31	61	92	122	153	184	214	245	275
Apr.	275	306	334	365	30	61	91	122	153	183	214	244
May	245	276	304	335	365	31	61	92	123	153	184	214
June	214	245	273	304	334	365	30	61	92	122	153	183
July	184	215	243	274	304	335	365	31	62	92	123	153
Aug.	153	184	212	243	273	304	334	365	31	61	92	122
Sept.	122	153	181	212	242	273	303	334	365	30	61	91
Oct.	92	123	151	182	212	243	273	304	335	365	31	61
Nov.	61	92	120	151	181	212	242	273	304	334	365	30
Dec.	31	62	90	121	151	182	212	243	274	304	335	365

DECIMAL EQUIVALENTS OF FRACTIONS

1/64	.0156	17/64	.26562	33/64	.5156	49/64	.7656
1/32	.0312	9/32	.28125	17/32	.5312	25/32	.7812
3/64	.0468	19/64	.29687	35/64	.5468	51/64	.7968
1/16	.0625	5/16	.3125	9/16	.5625	13/16	.8125
5/64	.07812	21/64	.32812	37/64	.5781	53/64	.8281
3/32	.09375	11/32	.34375	19/32	.5937	27/32	.8437
7/64	.10937	23/64	.35937	39/64	.6093	55/64	.8593
1/8	.125	3/8	.375	5/8	.6250	7/8	.8750
9/64	.14062	25/64	.39062	41/64	.6406	57/64	.8906
5/32	.15625	13/32	.40625	21/32	.6562	29/32	.9062
11/64	.17187	27/64	.42187	43/64	.6718	59/64	.9218
3/16	.1875	7/16	.4375	11/16	.6975	15/16	.9375
13/64	.20312	29/64	.45312	45/64	.7031	61/64	.9531
7/32	.21875	15/32	.46875	23/32	.7187	31/32	.9687
15/64	.23437	31/64	.48437	47/64	.7343	63/64	.9843
1/4	.25	1/2	.50	3/4	.7500		

MATHEMATICAL SHORT-CUTS AND CHECKS

Addition by Columns.—Add each column separately, beginning at the right, placing each result by itself. Then add the totals. Repeat the process, beginning at the left. See (1) below.

"Casting Out 9's."—Add the digits in each number, and divide the sum by 9. Place the remainders to the right of the number. Repeat for all numbers. Find the excesses of 9 in both the remainders and in the total. If the results are the same, the result proves. See (2) below.

Subtraction of Excesses of 9's.—Cast out 9's in minuend and subtrahend, and find the difference between the results. This should agree with excess of 9's in the remainder, if the subtraction is correct. See (3) below.

Casting Out 9's in Multiplication.—Find excesses of 9's in multiplier and in multiplicand. The product of these excesses should equal the excesses of 9's in the product. See (4) below.

(1)			(2)			(3)			(4)	
2175	2175		2175	6		465	6		465	6
5490	5490		5490	0		122	5		122	5
6312	6312		6312	3		343	1		930	30
5865	5865		5865	6		1			930	
12	18		19842	6					465	
23	16		6						56730	
16	23								3 = 3	
18	12									
19842	19842									

Multiplication by Multiples of 10.—Move the decimal point to the right as many points as there are 0's in the multiplier.

Multiplication of Numbers Ending with Zeros.—Multiply the significant figures. Add as many zeros as there are in both multiplier and multiplicand.

Multiplication by 9, 99, 999, etc.—First multiply by 10, or 100, or 1,000, etc. Subtract original numbers from the result.

Multiplication by 25, 50, 75, etc.—To multiply by 25, first multiply by 100; then divide by 4. To multiply by 50, first multiply by 100; then divide by 2. To multiply by 75, first multiply by 100, then divide by 4, and subtract this quotient from the product.

To Divide by 10, 100, 1,000, etc.—Move the decimal places to the left as many point as there are 0's in the divisor.

To Divide by 25, 50, 75, etc.—To divide by 25, divide by 100; then multiply by 4. To divide by 50, divide by 100; then multiply by 2. To divide by 75, divide by 100; then increase the quotient by ⅓ of itself.

Casting Out 9's in Division.—Find excesses of 9's in the dividend, divisor, quotient, and remainder. Excesses in dividend should equal excesses in remainder plus excesses in product of excesses of divisor and quotient.

Illustration: 6,793 ÷ 147 = 46, and a remainder of 31.

Excesses of 9's in	6,793 = 7
" " " "	147 = 3
" " " "	46 = 1
" " " "	31 = 4
	3 × 1 = 3
Excesses of 9's in	3 = 3
	4 + 3 = 7

SPECIAL RECORDS IN CONNECTION WITH PAYROLL TAXES

Old-Age Retirement Tax.—Under the old-age retirement plan, salaries, wages, commissions, etc., up to $3,000 are taxable. This tax is levied on both the employer and employee. The employee's share is deducted from his earnings by the employer. The employer is liable for the total tax, and must remit it to the Collector of Internal Revenue after the end of each quarter, with a report showing names of employees, their Social Security numbers, and taxable wages paid for the three preceding months. The tax must be deducted from the first $3,000 earned by every employee in each year; it cannot be distributed over the year.

Time and Payroll Record.—The form given on page 547 illustrates a typical time and payroll record. The column

TIME AND PAYROLL RECORD

WEEK ENDING.. 19....

NAME OF EMPLOYEE	WEEK DAY HOUR	TIME						TIME WORKED	RATE OF PAY	EARNINGS					Tax	WAGES PAID	REMARKS
		M	T	W	T	F	S			Wage	Other	Total	Taxable	Non-Taxable			

Time and Payroll Record

arrangement provides space for entering pay basis, working time, the wage rate, the amount earned (taxable and non-taxable), the tax, and the wages paid. A sheet or more should be used for each payroll week. When the payroll for the week is determined, a check is cashed for the amount shown in the wages-paid column. The check is entered in the cash disbursement record as a charge to the payroll account. The tax deducted from the employees for the month is journalized by charging the payroll account and crediting Old-Age Retirement Tax Payable. This tax and the actual wages paid for the month are posted to the payroll account and together make up the total earned wages for the month. The old-age retirement tax imposed on the employer is based on the total taxable wages, salaries, commissions, etc., earned. The amount of this tax should be charged to the Taxes Expense account and credited to the Old-Age Retirement Tax Payable. The total amount in this account is paid to the Collector of Internal Revenue quarterly.

Hours Worked.—Under the Federal Wage and Hour law, the employer is required to keep a record of the number of hours worked by each employee in each week. This information can be easily obtained from time cards or other records of attendance, and entered in the daily or weekly column on the time and payroll record shown on page 547. In that form a permanent record is maintained of this information as well as of salaries and payroll taxes deducted.

Wage and Salary Record.—Such a record is shown opposite. A sheet should be kept for each employee and a summary sheet filed in the front of the record. Postings should be made weekly or monthly to the individual sheets from the time and payroll record. This record can also be used to fill out Return of Information forms required by the federal and state governments for income tax purposes. The salary record is a per-

WAGE-SALARY RECORD

NAME.................................. S. S. ACCT. NO..............................

ADDRESS.............................. RATE OF PAY..............................

DATE STARTED..............................

OCCUPATION.............................. LEFT..............................

PERIOD ENDING	TIME WORKED	EARNINGS			Tax	PAID	REMARKS
		Total	Taxable	Non-Taxable			

Wage-Salary Record

petual record and must be maintained for reference purposes. The total by years can be separated by leaving a blank line.

Unemployment Insurance.—The unemployment insurance tax is paid to the federal and state governments. The federal rate is now 3% of total salaries, wages, commissions, etc., less credit for unemployment insurance taxes paid to states not in excess of 90% of federal tax, and is payable entirely by the employer. An annual report is filed with the federal government after the end of each calendar year. The earned wages and salaries shown on this report can be taken from the summary sheet in front of the wage and salary record book. The tax may be paid in one payment or four equal quarterly installments.

This tax should be accrued on the books of account as of the end of each calendar or fiscal year, so that the tax charge will be allocated to the proper period. The accrual entry is a debit to Unemployment Insurance Tax, and a credit to Unemployment Insurance Tax Payable.

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